PROBLEMS FACING SMALL BUSINESS IN HAWAII

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS
FIRST
~~SECOND~~ SESSION

HONOLULU, HI, NOVEMBER 28, 1983

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
36-312 O WASHINGTON : 1984

H721-20

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CONTENTS

Page

Hearing held on November 28, 1983 ... 1

Opening statements of:

- Akaka, Hon. Daniel K., a Representative in Congress from the State of Hawaii ... 2
- Hayes, Hon. Charles A., a Representative in Congress from the State of Illinois ... 5
- Mitchell, Hon. Parren J., chairman, Committee on Small Business ... 1

Testimony of:

- Arakawa, Goro, director, Retail Merchants of Hawaii ... 125
- Belmont, James E., president, Hawaii Pipe and Supply Co ... 40
- Brody, Lex ... 129
- Donaghy, Joe, president, Maui Light House, Inc ... 79
- Franklin, Harold H ... 127
- Keith, Kent M., director, Department of Planning and Economic Development, Office of the Governor, State of Hawaii ... 18
- Kido, C. Mike, president, Construction Industry Legislative Organization, Inc ... 39
- Luiz, Douglas E., executive president-secretary, M. Wantanabe Electrical Contractor, Inc ... 40
- Lyons, Tim, director, The Legislative Center, accompanied by Darrell Choy, president, Hawaii Pest Control Association, and Wally Miura, Hawaii Flooring Association ... 84
- Miura, Wally, president, Wally's Flooring, Inc., accompanied by Allen L'Espanos, resource person, General Contracts Association of Hawaii ... 51
- Nakagawa, David K., District Director, Honolulu District Office, U.S. Small Business Administration ... 6
- Robinson, Robert B., president, Chamber of Commerce of Hawaii ... 56
- Sloan, Sam, executive director, Small Business in Hawaii ... 130
- Tatum, Bette, chairman, Governor's Small Business Advisory Committee, and State director, National Federation of Independent Business ... 65
- Waidzunas, Richard J., District Advocate for Business Development, U.S. Small Business Administration ... 8

Additional material supplied for the hearing record:

- Arakawa, Goro, director, Retail Merchants of Hawaii: Prepared statement ... 126
- Ariyoshi, George R., Governor, State of Hawaii: Prepared statement ... 18
- Donaghy, Joe, president, Maui Light House, Inc.: Prepared statement ... 81
- Kalapa, Lowell L., director, Tax Foundation of Hawaii: Prepared statement ... 101
- Keith, Kent M., director, Department of Planning and Economic Development, Office of the Governor, State of Hawaii:
  - Letter to Chairman Mitchell re economic benefits information on loan programs ... 38
  - Prepared statement ... 23
- Kido, C. Mike, president, Construction Industry Legislative Organization: Prepared statement ... 52
- Lyons, Tim, director, The Legislative Center: Prepared statement ... 87
- Mason, George, publisher, Pacific Business News: Prepared statement ... 99
- Pellegrino, Anthony: Prepared statement ... 98
- Potter, Nathaniel R., Jr., vice president of marketing, Lone Star Hawaii Cement Corp.: Prepared statement ... 95

Page

Additional material supplied for the hearing record—Continued
  Robinson, Robert B., president, Chamber of Commerce of Hawaii: Prepared statement 59
  Shimizu, Edwin J.: Prepared statement 96
  Tatum, Bette, chairman, Governor's Small Business Advisory Committee, and State Director, National Federation of Independent Business: Prepared statement with attachments 66

PROBLEMS FACING SMALL BUSINESS IN HAWAII

MONDAY, NOVEMBER 28, 1983

House of Representatives,
Committee on Small Business,
Honolulu, HI.

The committee met, pursuant to notice, at 9 a.m., in the Federal Building, Aha Nonoi Courtroom, Honolulu, HI, Hon. Parren J. Mitchell (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN MITCHELL

Mr. Mitchell. Good morning. This hearing will now come to order.

Good morning, ladies and gentlemen. First of all I want to say what a pleasure it is for me to be here in Honolulu. The district that I represent is mainly comprised of the city of Baltimore, MD, and portions of Baltimore County. When I left last week it was snowing in Baltimore. So you know I am especially happy and grateful to be here.

I want to particularly thank your Congressman, Dan Akaka. He forcefully urged the Small Business Committee to have hearings in this district. In fact, he did more than urge, he told me to come here. It wasn't an urging, it was a demand, "You show up and have a hearing."

Many times in the past when I fought for a position very strongly on the House floor, after I have fought and particularly if I have won my battle, some of the Members tell me where I can go in private. However, I can simply say that thanks to Danny, he told me to come to paradise rather than the other place where some of the other Members tell me to go.

It is just delightful and I can understand why you call this paradise.

There are in addition to your Congressman, two other members of the committee here, Congressman Gus Savage of Illinois, to my right which is most unusual, he is generally politically to my left; and Congressman Charles Hayes of Illinois, to my left, which is about par for the course.

Three other members of the committee were scheduled to be here but as you know there are some difficulties on the mainland in transportation. There seems to be some heavy precipitation on the mainland. I don't know what it is, but three other members of the committee have been unable to join us.

When I was elected chairman of the House Small Business Committee almost 3 years ago, after very careful thought I concluded that one of the chief problems of small businesses with regard to the Federal Government was and remains one of communication or really a lack of communication. It's a lack of communication between the small business communities and the Congress of the United States.

I can testify that the Members of Congress are indeed intensely interested in small business and fully supportive of small businesses. But the big problem is making the Congress aware of the problems of small business in a direct fashion.

The large corporations simply don't have this problem. Almost all of the large corporations have their lobbyists in Washington, but most small businesses cannot afford to come to a Washington hearing; they cannot afford to have an army of lobbyists, and they cannot afford time away from their business to come to Washington for a hearing.

Therefore, one of my first priorities when I became chairman of the committee was to attempt to overcome this information gap by going to small business communities and holding field hearings. In the past 3 years we have done so; we have had field hearings in cities like San Diego, San Francisco, and Seattle on the west coast, and Atlanta in the south. We also will be going to the relatively small city of Columbia, SC.

After today I am pleased we will be able to add Honolulu to the list of the dozen cities or so in which we have had hearings.

I believe that I can speak for the full committee, both Republicans and Democrats, in saying that hearings like this are very, very important and provide us with a great deal of valuable information. Today we will have witnesses who are local experts in their fields and who will address such topics as the availability of Federal Government assistance to small business in Hawaii; the availability of capital for small business startup and growth; specific problems small businesses encounter because of their location in the Hawaiian Islands, and a host of other problems.

With that background, I would recognize Congressman Akaka for an opening statement if he would like to make one.

OPENING STATEMENT OF HON. DANIEL K. AKAKA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF HAWAII

Mr. AKAKA. Thank you very much, Mr. Chairman.

I have more than a statement to make here. I first want to thank the chairman, Parren Mitchell, for coming here to Hawaii to hold these hearings; also to thank Gus and Charlie for coming to Hawaii to join Parren.

But I want to take a little time to tell you about Parren Mitchell. When I was first elected to Congress, my office was in the Cannon House Office Building and almost across from my office in the same hallway was Parren Mitchell's office, and this was the beginning of our friendship in Congress. Parren has been one that has represented his constituency well. If there is one word, not only for his constituency, but even for the business people, small business people, that label for Parren Mitchell is humanitarian. He is a humanitarian.

If you were to look at his record in Congress in what he has done, this becomes very clear. He has helped people, he has helped me in particular, with some of our problems far out here in Hawaii, and has been very concerned about human rights, very concerned about problems that little people have and he has done very well to support this kind of legislation.

Parren Mitchell has been a leader in Congress and I want to tell you that every time Parren stands up to talk on the floor people listen. He might disagree with me at some times, but people stop and they listen to what he has to say because he has a record of saying things that are very, very important, very vital to whatever the discussion is, and so Parren has this kind of respect from Members of Congress and he is certainly a leader in Congress.

I am glad to also have Gus Savage here. Gus, compared to Parren and I, is a newcomer to Congress, but in the short time that he has been there, Members have recognized him for his ability as a leader. He has been one that has been all over the place, I should say, on the floor, has made many friends there and he brings to Congress a kind of expertise that has helped the decisions in Congress.

As was mentioned, he comes from the State of Illinois and he brings to us the kind of expertise in academia that helps our decisions there.

Charlie Hayes is a newcomer, but in the short time there has made friends. I keep saying this, has made friends. When I first got to Congress this was what I needed to do, to make friends so that you can count on your friends for help.

Charlie, in the short time he has been there, has made many, many friends in Congress and has supported the kind of issues that we here in Hawaii are interested in and the kind of issues of small business that is vital to our country.

So I am glad to have all of them here and welcome them to Hawaii. I want to then finally thank Parren Mitchell for really making the arrangements that have brought them to Hawaii.

Mr. Chairman, others will expand in more detailed fashion about the vital importance of small business to the economy of Hawaii but I want to just quote from the State of Hawaii data book that can really tell the story: "Business establishments with one or more employees in 1980 numbered 21,124. One hundred had 250 or more employees." That tells you the impact that small business has on our economy of Hawaii.

Exact figures will vary but the overriding fact is that small business is the life's blood of our State and really of our country. Although I know this dependency on small business is not singularly extraordinary among the 50 States, it is not common either and it becomes totally unique when one considers that we are separated from the nearest point on the continental United States by 2,500 miles of water.

As a result, small business in Hawaii suffers from tremendous disadvantages, ranging from geographical to attitudinal when it comes to dealing with the Federal Government at all levels.

Today, Mr. Chairman, you will hear many examples, one, onerous but unavoidable, transportation costs, as well as the ever-present specter of transportation disruption.

Two, limited startup and growth capital in a high cost State.

Three, lack of accessibility to Federal information and assistance.

Four, the awarding of contracts for everything from construction work to phonograph records to medical supplies to mainland firms when local businesses have offered closely competitive or equal bids, more immediate availability of services and inventory and firsthand accountability. These and many more problems stem for the most part from our physical isolation and sense of detachment that that isolation breeds in those on the mainland whose actions impact directly or indirectly on our daily lives here in Hawaii.

That is why, Mr. Chairman, I am especially grateful to you and the committee for taking the time to meet with representatives of our small business community. At least in this instance they may now have confidence that some of those who play a part in affecting their futures will not be making decisions on the basis of secondhand preconceptions or misconceptions, but on the basis of person-to-person communication.

Thank you very much, Mr. Chairman.

Mr. MITCHELL. Thank you, Congressman Akaka. Thank you for the kind words that you said about us.

Congressman Savage, do you have an opening statement?

Mr. SAVAGE. No, I don't have an opening statement, Mr. Chairman. I would just like to make this observation, however, that I am sure everyone here has good reason to be very proud of Danny because indeed he perhaps has more friends than anyone in Congress and as you know perhaps better than do I that to know Danny is to love him. But let me also say I have learned in the short time I have had the privilege of knowing him that above all he is a very serious man about his work, and his deep concern for the welfare of this State is somewhat shown in our presence here today and I would like to also of course join with him in commending the chairman who is most directly responsible for our being here—certainly my being here—because he has taught us well of his own great interest and concern for small businesses and particularly for small businesses of all States to gain their fair share regardless of the distance.

If I might just add, it certainly should be less difficult if it is at all, in the future, to cause congressional committees to hold hearings and fact-finding missions here after I spread the word back home about how great Danny's hospitality and your hospitality has been.

It even exceeds the beauty and the great climate of this great State.

Thank you.

Mr. MITCHELL. Thank you very much.

Congressman Hayes.

OPENING STATEMENT OF HON. CHARLES A. HAYES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. **Hayes**. Chairman Mitchell, just let me echo what has been said by you in terms of this magnificent island State and let me say ditto to your remarks and those of Congressman Savage about Congressman Akaka and his role in Congress. As has been said, I am the second newest Member of Congress now. Just a week or so ago there was a replacement for Congressman McDonald from Atlanta who went down on that ill-fated plane, 007. That made him the newest Member of Congress.

I have been installed in September of this year. I certainly feel privileged to have an opportunity to serve on this committee since I come from a district in Illinois, in Chicago, where most of the businesses within that district—some 500,000 people live there—are small businesses.

We don't have any big businesses at all except maybe for two or so food chains in that whole district. So we have a common interest. Although I come to Congress with a sense of labor background having been a trade union leader for a number of years, my concern has been for the plight of small business. The survival and growth of small business is of interest to me and interest to other Members of Congress.

In this age of consolidation and monopolization it's more and more difficult for small businesses to survive and actually small business is one of the main sources for jobs for many, many people. I am trying to find ways and means that I can be helpful as a member of this committee and as a Member of Congress and in order to do that, certainly I have to know—as do other members of our committee—what some of the shortcomings are, if any, what the pluses and minuses are here on the island in this State of Hawaii and I am just here to find out how I can be helpful.

Thank you, Mr. Chairman, for having the foresight in conjunction with Congressman Akaka for having set these hearings up here in Honolulu. Thank you.

Mr. **Mitchell**. Thank you. I thank all of you gentlemen.

Now we get to the main purpose of being here, that is to hear from you. We wanted to express our gratitude and thanks and pleasure of being here but the essential thrust of this hearing is to hear directly from you. We will start out with our first two witnesses and we will take them as a panel, David K. Nakagawa, District Director of Honolulu district office of the U.S. Small Business Administration, and Richard Waidzunas, business development district advocate of the U.S. Small Business Administration.

Would you two gentlemen come forward to the witness table, please.

It's my understanding that we have copies of your written testimony and we will of course submit your entire statement for the record. It will be incorporated in the record and if you go through and hit the salient elements in your testimony, that would be helpful.

Thank you for taking time from your busy schedules to be with us.

TESTIMONY OF DAVID K. NAKAGAWA, DISTRICT DIRECTOR, HONOLULU DISTRICT OFFICE, U.S. SMALL BUSINESS ADMINISTRATION

Mr. NAKAGAWA. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I consider this a privilege to have this opportunity to testify on the availability of Federal Government assistance to small business in Hawaii and the U.S. territories of the Pacific. Appearing with me are Robert Thome, chief of finance and investment, Janet Nakasone, chief of management assistance; Richard Zukemura, chief of procurement assistance; and Richard Waidzunas, business development specialist.

Mr. George Grant of your staff suggested that my comments be expanded to include the Pacific territories. I am pleased to do so.

The Honolulu district office and the Guam branch office are responsible for the delivery of the full range of financial, management and procurement services in seven independent, separate political jurisdictions in the Pacific. They are the State of Hawaii, territories of Guam and American Samoa, Commonwealth of the Northern Mariana Islands, the Federated States of Micronesia, Republic of Marshall Islands, and Republic of Palau. Each jurisdiction has its own commercial laws, land tenure system and local custom and usage. In terms of geography, the Honolulu district office covers an area twice the size of the 48 contiguous States.

As is expected, there are contrasts and diversity. For example, there are only 5,000 people in the entire State of Yap; 1 million in the State of Hawaii. Basic infrastructure in the Pacific territories are still in the process of development; it is overdeveloped here in Waikiki as you can see.

The communication system is incredibly inefficient in the Pacific territories; the problem is aggravated by language barriers and diverse cultural values. Banking services are improving throughout the Pacific, but we still encounter unusual problems in packaging SBA loans. Outside of Hawaii and Guam, we simply do not have the resource to make and service SBA direct loans, so we rely mainly upon the commercial banks to meet the credit needs of small business with or without SBA participation.

In Guam, we are working with the local people to organize a 503 development company structured to provide long-term asset financing to small business in Guam and the Northern Mariana Islands. We are pursuing a different course for American Samoa. Because the market is too small to support an independent development company, we are preparing a proposal to amend our regulations to permit a development company in Hawaii to make 503 loans in American Samoa.

It is contemplated that, on a case-by-case basis, the 503 loan applicant will be utilizing professional loan packaging service available in Honolulu. In Hawaii, our 503 loan program is being implemented through the HEDCO Local Development Corporation which was certified by SBA last year. To date, we have funded five expansion projects in the total amount of $3,356,400, creating a total of 77 new jobs.

Mr. Chairman your committee is well aware of the variety of assistance programs designed by Congress for the benefit of small business. As I listen to the owners and managers of small business, as I frequently do, they do not feel such programs are readily available to them, particularly in the Pacific territories. Their prime concern is financial assistance which they perceive to entail "red tape" and "delays." To address this problem, we started a pilot program, 2 years ago, to test the feasibility of centralizing loan packaging service under a clearinghouse in order to improve the quality of loan packages, and to control packaging fees. We gave the project to the Chamber of Commerce in Honolulu 6 months ago. I believe Mr. Evans of the Small Business Council will explain this project in more detail.

In the meantime, we are working with the people in the Pacific territories to establish their own loan packaging service centers for their respective small business communities.

Under the constraints of our travel budget, we visit our neighbor islands on a circuit ride every 6 weeks, less frequently to the Pacific territories, but thanks to the local banks and the chamber of commerce, a variety of information relating to Federal Government assistance is made available to small business, along with application forms and publications. In addition, with the cooperation of the local banks, chambers of commerce and government agencies, we are delivering our management training and counseling service on an on-going basis throughout the Pacific.

Counseling services are rendered by our SCORE and ACE volunteers who are domiciled in the State of Hawaii and Guam, 3,800 miles apart. Here again, our travel budget limits the frequency of counseling services outside of Hawaii and Guam.

Statistics published by the State of Hawaii indicate a tremendous growth in exports over the 10-year period of 1973–82. Imports, however, have increased at a much more rapid rate resulting in an even greater rate of increase in Hawaii's "trade deficit." Although the statistics published are somewhat distorted by the import and export transshipments, there is clearly a significant imbalance in Hawaii's foreign trade.

One reason offered for this imbalance is that many small business persons are simply not informed about their potential to export, nor are they knowledgeable about the process, as well as the many details to be addressed in order to export a product or service successfully. Export terminology, feasibility studies or market research, financing, insurance, political risk, documentation, sources of assistance, and so forth, are unknown to many of them.

Passage of the Export Trading Company Act on November 8, 1982 should be of benefit in this regard. However, the local office of the International Trade Administration reports limited interest in the formation of ETC's here in Hawaii.

With SCORE participation, we have cosponsored foreign trade workshops dealing with the basic requirements for international trade to complement those offered by ITA. During fiscal year 1983, three were held, and another three are scheduled for fiscal year 1984.

No loans have been made under our Export Revolving Line of Credit, ERLC, Program. It is clear that we must, and we are, contacting the banks to encourage them to utilize this program.

Total Small Business awards in Hawaii have increased from 44 percent in fiscal year 1981 to 63.5 percent in fiscal year 1983. Correspondingly, small business set-aside awards increased 17 percent in fiscal year 1981 to 38.3 percent in fiscal year 1983. Contracting officers are supportive of our goals and are doing a good job in administering the set-aside program.

Here in Hawaii, three prime contractors deal with commercial products. Most of the prime contracts awarded with subcontracting requirements are not completed, so all of the data are not available; however, on the basis of current information, we wish to report that of the total subcontracting amount of $114,792,000, $33,281,000 or 28.9 percent has been awarded to small business and $29,697,000 or 25.8 percent has been awarded to small disadvantaged firms.

Mr. Chairman, members of the committee, thank you for your time and interest in the activities of the Small Business Administration. We are prepared to respond to any question you may wish to pose.

Mr. MITCHELL. Thank you very much.

What I think, if it is agreeable with the members of the panel, we will take the second witness and then put questions to both of you.

Thank you, sir.

TESTIMONY OF RICHARD J. WAIDZUNAS, DISTRICT ADVOCATE FOR BUSINESS DEVELOPMENT, U.S. SMALL BUSINESS ADMINISTRATION

Mr. WAIDZUNAS. Mr. Chairman, committee members, I wish to thank you for this opportunity to appear before you. It's my intent to brief you on the delivery of the following SBA programs, the 8(a) program, Advocacy and Veterans Affairs, by the Honolulu district office.

The 8(a) program was started in Hawaii in 1975. In the first year of operation, there were 24 contracts for a total volume of $903,059. The average contract was $37,627. There were 18 firms approved for 8(a) eligibility.

At fiscal year end 1983, there were 109 contracts for a total volume of $10,483,077. The average contract was $96,175. We have 30 firms in our 8(a) portfolio here.

Ownership of the 30 firms is 3 black; 2 Hispanic; 5 Native Americans, that is Hawaiians; 20 Asiatic-Pacific. Ninety-seven percent of the firms received at least one 8(a) contract during fiscal year 1983. Seventeen firms are in general or specialty trade construction; 11 are nonprofessional services; 1 is professional service, and 1 is manufacturing.

Four of the 30 firms are located on Guam; 1 in American Samoa; 1 on the Island of Kauai; 2 on the Island of Maui; and 22 on the Island of Oahu.

As you can visualize this poses distinctive problems in communications and logistics. The Honolulu district office deals with 10 different military contracting agencies and 5 different civilian contracting agencies.

About this time last year, I called a meeting of the nine "Small and Disadvantaged Business Utilization Specialists [SADBUS]" within the local military contracting establishment. It was agreed that each contracting activity wanted to expand their bidders mailing lists to assure more competitive bidding and that many firms who were entering the Government procurement arena for the first time, lacked knowledge in proper bidding procedures. As a result half formed a steering committee to plan a procurement conference; the other half was to work with SCORE in producing a curriculum for a Government contracting workshop.

On June 3, 1983, the procurement conference was held at the Sheraton-Waikiki Hotel. It was attended by over 350 individuals who were interested in providing products and services to not only the Federal Government, but also the State of Hawaii and the city and county of Honolulu. The conference was sponsored by Congressman Cecil Heftel and members of the small business coalition which you will hear about later.

On June 21, 1983 the first Government contracting workshop was held and was attended by 150 individuals. The unique feature of this all day workshop was that the SADBUS and other contracting personnel participated in the presentations. A second workshop is now scheduled for January 19, 1984.

It is my intent, through the minority business opportunity committee of the federal executive board, to push for regular quarterly meetings of the SADBUS. The purpose would be to surface common problems that we face regarding procurement for minority-owned businesses and, hopefully, to increase the share of contracts set-aside for 8(a).

With respect to 7(j) funding, this office received an award of $36,300 plus $7,650 for travel expense for 7(j) (1) through (9) and $20,625 plus $3,500 for travel expense for 7(j)(10). We issued 38 task orders for 33 7(j) (1) to (9) clients, and 23 task orders for 12 7(j)(10) clients.

Toward the end of the fiscal year we asked the 7(j) clients to respond to an evaluation survey of the 7(j) contractor work. We received approximately 40 responses and, with the exception of two or three fair ratings, the remainder considered the consultant's work and recommendations to be excellent. The majority had, or were going to, implement the consultant's recommendations.

We were also able to acquire funding for a 7(j) special project. The project was to produce videotapes and self-instructional material so that the tourist oriented business could cater to the large number of Japanese tourists which visit Guam, Saipan, and Hawaii. It gives local employees of hotels, restaurants, shops and airline reservation offices a working knowledge of the Japanese language and customers. The total production cost was $14,713.

We plan to establish training centers in various community colleges on Guam and Saipan so that employers can send their employees to training sessions. This should help to increase revenues over current levels and thus create additional jobs.

The Honolulu district office breaks advocacy into two distinct areas.

Our first concern is with achieving a better business climate in which small business can operate more profitably within the State of Hawaii.

In late 1980, shortly after being designated as the district advocate, I put together a steering committee to start planning the first statewide small business conference. The committee was composed of State and SBA employees and representatives from the National Federation of Independent Businesses, Hawaii Business League, Chamber of Commerce and their Small Business Center. The first conference was held on November 16, 1981 with an attendance of 650 participants.

Participants recognized 49 areas of concern to Hawaii's small businesses. Primarily, it was in the areas of unemployment benefits, workmen's compensation, unemployment insurance laws, hiring policies of State and county units, inheritance tax law, et cetera.

The representatives of NFIB, HBL, chamber, Small Business Center and SBA decided to form a Small Business Coalition. During the regular Hawaii State legislative sessions. The coalition meets regularly to discuss legislative proposals relating to small business problems and issues. I am very proud to advise you that we have been informed that Hawaii is the only state in the union that has such a Small Business Coalition.

A further result of this first conference was to get the legislature to pass a resolution urging the Governor to form a "Small Business Advisory Council" composed of several State Department heads and members of the Small Business Coalition. The advisory council is formed and operating.

The Third Annual Statewide Small Business Conference was held on Oct. 21, 1983. Four hundred participants were on hand. Attending also were 28 of the 76, or 37 percent State legislators. We look to a fruitful year during the coming legislative session.

Advocacy's second concern is to work with small businesses which may have unique problems in procurement and with the trust territory governments and businesses who may need specialized training and/or business development. The majority of complaints I received concern the slow pay of the contracting agencies. We counsel them regarding the Prompt Payment Act and then contact the contracting officer regarding the slow pay.

In many cases we find that the contractor had submitted an improper or incorrect invoice, and, although advised by the contracting officer, had failed to take corrective action. We assist the small business to make the necessary corrections and payment is soon in hand. In one case we persuaded the contracting officer to cable Navy ships for necessary authorizations to pay invoices for food supplies which were 6 months past due.

Another case was a painting contractor who was advised that he would possibly have to refund $100,000 on a family housing contract which he had worked on for the past 12 months. Investigation revealed that contract administration had erred, that the error was theirs and not the contractor's. Presented with the evidence, the contracting officer decided to drop any action to recover.

While traveling to American Samoa in 1980, I noted a preponderance of breadfruit rotting on the ground. Upon my return to Honolulu I contacted Ken Froelich, chairman of Frito-Lay of Hawaii, Inc. and was advised that breadfruit chips could be made. Arranging for airfare and per diem through an MBDA agency, Ken went to Samoa and did a feasibility study which indicated that the breadfruit chip industry would be economically feasible as an import substitution.

The next step was to identify potential local entrepreneurs, which we did on our next trip. They were given copies of the feasibility report and advised that if they could fund a trip to Honolulu, we could provide technical training and knowledge through Frito-Lay plus development of their business plan and loan package. Two responded and came to Honolulu.

For 6 months we heard nothing until I received a phone call one day from one of the entrepreneurs—believe it or not, a woman Dorothy Gurr. She was passing through after being to the mainland to purchase equipment. The Development Bank of American Samoa had given her a loan of $60,000 and she planned to start production in January 1982. Frito-Lay offered to send their production chief to assist in startup operations.

At year end 1982, the firm grossed $90,000, showed a modest net profit of $2,500, and hired seven people. In July 1983 we sent our 7(j) contractor to assist in fine tuning the recordkeeping system, preparing an updated financial statement, check the cost and pricing system and identify any major problems. The operating statement for period end August 31, 1983 showed a gross of $60,801 with a net profit of $5,100 and 10 employees. We are now looking for export markets for this firm.

As for training coordination, we have gotten the Bank of Hawaii to administer some credit analysis correspondence courses for the staff of the Development Banks of the Republic of Palau and Marshall Islands; Yap has sent an economic development officer for training in loan packaging and feasibility study preparation, which was done by SBA and Bank of Hawaii personnel; the State of Ponape sent their legislative budget officer for training with the city and county of Honolulu budget office which we arranged; Yap again sent their tourism analyst for training in the visitor industry which we arranged with the State Department of Tourism, various hotels, travel agencies and other tourist related businesses.

Our outreach efforts for the past year have been very unsuccessful. We contacted the various veterans organizations in Hawaii and have yet to have one respond.

In August 1983, I was contacted by Michael Wix, the program director for the newly established Hawaii Vietnam veterans leadership program. Together we have devised an outreach program which hopefully will work. On December 5, 1983, we will have an organizational meeting to establish a "Veteran's Business Resource Committee." The board will consist of prominent businessmen and business executives who are Vietnam-era vets.

At present I do review all declined loan applications from F&I in order to see what resource may be available to assist in improving the declined application. All inquiries by veterans are directed to me.

This concludes my statement to the committee. I would be pleased to respond to any questions that the committee may have.

Mr. MITCHELL. Thank you very much for your statement.

We do have questions, of course. I want to apologize. I failed to introduce the gentleman in the back with the white shirt on, that is Thomas Powers who is our chief legal counsel on the House Small Business Committee. We certainly owe him a great deal for his preliminary work in coming over a little earlier to set these hearings up.

Let me get to a couple of questions.

First of all to Mr. Nakagawa, you are not making any direct loans because you say you don't have the personnel and some other problems like that?

Mr. NAKAGAWA. My testimony, Mr. Chairman——

Mr. MITCHELL. Let me say, I am strong on direct loans. I know the administration in Washington is not, but I am very strong on them because it's been my experience around the country that the banks are rather reluctant to participate even in a guaranteed loan program. It's different in Hawaii I know; the banks bend over backward to make loans. So you don't have that same problem that we have on the mainland. But I would suspect that you do need direct loan money. You say you can't do it because you don't have the personnel?

Mr. NAKAGAWA. In Hawaii and Guam where we have the personnel stationed in these two localities we have been making direct loans. The direct loans are not made outside of Guam and the State of Hawaii because we don't have any resources to service these loans. As I pointed out, the geographic area that we cover is so large and so expensive to service these loans, we are making loans only in participation with the banks in American Samoa, Northern Marianas, and all the Trust Territories.

Mr. MITCHELL. Well, it would just seem to me if that is the problem, the problem of servicing, then Mr. Advocate, you ought to be there yelling at Washington saying there is a gap out there because we don't have the personnel to do the servicing. Wouldn't that be the proper thing to do?

Mr. WAIDZUNAS. Yes, sir.

Mr. MITCHELL. Have you done it?

Mr. NAKAGAWA. We have.

Mr. WAIDZUNAS. Yes.

Mr. MITCHELL. Washington has turned a deaf ear?

Mr. NAKAGAWA. I don't know if it is deaf——

Mr. MITCHELL. Maybe I shouldn't say a deaf ear.

Has the hearing aid been turned down?

Mr. NAKAGAWA. It has been turned down. As a matter of fact, as you are well aware, Mr. Chairman, the personnel ceiling for the Small Business Administration, as in all other Federal agencies, has been reduced, and under these circumstances it does not appear to me to be realistic to be asking for more personnel here in the Pacific.

We are doing our job through the private sector and through local government agencies.

Mr. MITCHELL. Well, I will fight the battle for you because we think it is nonsensical to reduce personnel. We fought every step of the way that this administration has taken to reduce personnel in the SBA.

The argument through the years has been we have a high default rate on direct loans and other things because we have one person with a portfolio of 300 loans. If that is true, it is logical to add personnel, not to take away. Don't you do it here; we will fight that battle for you.

Mr. NAKAGAWA. Thank you.

Mr. MITCHELL. Now, I have one other question. I am all in favor of seminars and workshops. I think they are enormously helpful in educating people. I have been to many of them. I always enjoy the coffee and donuts served at the workshops and seminars.

However, for me, the bottom line is what comes out of the seminars and workshops in terms of contracts, in terms of real opportunities that we can count. You indicated that you have had two workshops.

Mr. WAIDZUNAS. We just had one. That was the first one, June 21, 1983. We will be having the second one on January 19.

Mr. MITCHELL. How many contracts came out of the first?

Mr. WAIDZUNAS. I have no idea, sir.

Mr. MITCHELL. That is critical.

Mr. WAIDZUNAS. Yes.

Mr. MITCHELL. Absolutely critical.

Every time a workshop or seminar is put on, there has to be a followup: Did a company get a contract as a result of the workshop or as a result of the trade fair? Unless we do that on a very meticulous and assiduous basis, we are really almost running the danger of going through a social exercise, really, where we simply bring people together, establish a collegial atmosphere; everybody eats and talks and nothing happens.

I would urge very strongly that every time a workshop or seminar is put on, somebody further down the line contact all those participants that you had there and ask if you got something out of value from the workshop, meaning a tangible contract.

Mr. WAIDZUNAS. Yes.

Mr. MITCHELL. Congressman Savage.

Mr. SAVAGE. No questions, Mr. Chairman.

Mr. MITCHELL. Congressman Hayes?

Mr. HAYES. Just one. I am just a little curious.

You mentioned that the communications system is incredibly inefficient in the Pacific Territories. I wondered if you had any specific suggestions as to how we might improve communications in Congress through our committee?

Mr. NAKAGAWA. This particular problem, Congressman Hayes, is being addressed primarily through the Interior Department, and also through the Pacific Basin Development Council. It takes time, and it takes a lot of money to do this in a vast geographic area such as we are referring to. I find that communications have been improving in the past 2 or 3 years.

For example, we can call American Samoa and speak very readily through the telephone. The same in Ponape, Northern Marianas, and Palau. These are recent developments. But the telephone system within the Northern Marianas, for example, is so inefficient that it is frustrating to try to use the phone system out there. Generally what we do is just jump in our cars, go out and track down the people we want to meet with.

Mr. HAYES. No further questions.

Mr. MITCHELL. Congressman Akaka, let me stop this foolishness. Is it all right if it is Gus and Charlie and Dan?

Mr. HAYES. You know it is all right.

Mr. MITCHELL. Small businesses don't believe in a lot of formality and protocol.

Danny.

Mr. AKAKA. Thank you very much, Parren.

One question. This has to do with your comment of having an imbalance, a significant imbalance in Hawaii's exporting and foreign trade.

You point out that it is what we do to businesses being uninformed about export technology and what possibly would be available as resources to them for export-related matters.

My question is, what status is this in now to try to increase export awareness for small business products from Hawaii?

Mr. NAKAGAWA. I definitely feel that the small business concerns who have a product or service to export need to be encouraged, need to be trained so that they will realize that there is business outside of the State of Hawaii that is profitable to them. In order to achieve that, we are starting with seminars and workshops and counseling services, one on one.

For example, in the Small Business Administration we have the Service Corps of Retired Executives, and within that chapter we have identified an International Trade Committee headed up by a retired business executive who happened to have been an international banker. Along with him, there are several other people who are making efforts in counseling small business on a one-on-one basis. These are the steps we are taking.

Mr. AKAKA. Since you have been aware of this, has there been any improvement toward increasing exports?

Mr. NAKAGAWA. We have no statistics to show for this. It is just a feeling on my part that, yes, there is a definite improvement that is taking place.

Mr. AKAKA. Thank you very much.

Mr. MITCHELL. Gus.

Mr. SAVAGE. Let me ask Mr. Nakagawa, just give us a better feel of the inadequacy of your resources to which you refer in your statement. In terms of personnel, just what does it mean? What is the quantity of personnel presently? What would it need be for you to feel that you would be adequately staffed?

Mr. NAKAGAWA. Yes.

Mr. SAVAGE. I am trying to get a handle on what percentage you are undermanned.

Mr. NAKAGAWA. It depends on what we set out to accomplish. If we set our goals high, understandably we will need more personnel. But our goals have been changed in the last 2 years to leverage on the private sector and the local government agencies in order to extend the services of the Small Business Administration to the small business communities throughout the Pacific.

That was the point that I was trying to get across to this committee: We are serving the small business communities but we are doing this with the help of the private sector and the local government agencies, particularly the chamber of commerce.

Mr. **Savage**. I presume that there is some standard that you would consider ideal or normal for you to say that your resources are inadequate to service these direct loans.

Could you quantify how inadequate in terms of personnel, and while you are at it, also in terms of budget, because you make reference to the inadequacy of your budgetary provisions for travel? Also you have the problem of communications.

Is there anyway to give us some feel in terms of quantity with respect to personnel and budgetary needs so that you would not feel your resources would be inadequate?

Mr. **Nakagawa**. Congressman Savage, I would be happy to review the total resources that we have and compare it to the needs of the different communities in the Pacific.

Let me again go back to that statement I have made that the geographic area that is covered by this particular district is so large that we are faced with enormous kinds of logistics problems. I for one am not going to be unrealistic in believing we can have adequate personnel stationed in Palau, in the Marshalls, in Ponape, in Truk and all of these different islands that are spread out over the Pacific.

Rather than doing that, my approach at the present time is to extend bank participation loans. The banks are there and they have branches. We are using that particular resource in making loans available to small business.

So, to answer your question directly, I would need time to review the kind of resource that we have, how we can spread these resources out.

Mr. **Savage**. May I interrupt you, Mr. Nakagawa, again?

You say you do not have the resources to make and service SBA direct loans. While you may not be prepared at this moment to quantify that, to be more specific, I gather that implies—correct me if I am wrong—that you do not feel that you have a sufficient staff and budget to do whatever you think you should be doing.

Is that right?

Mr. **Nakagawa**. That is correct. If we have unlimited resources in terms of travel funds and personnel, what we can do is to set up branches or duty stations in all these different islands.

Mr. **Savage**. Mr. Chairman, obviously no one can talk in the real world about unlimited anything, particularly not unlimited when you talk about government tax dollars for personnel and budget. So that is not what I am trying to get at, Mr. Chairman.

Though you might recall during our hearings earlier this year or last year when the Director of the SBA came before us and was questioned with respect to his budgetary request, particularly with regard to staffing, he was pressed because it was felt by many of us on the committee, including our chairman, that his request was inadequate. I am trying to be more specific with regard to this need, because next time he comes before us I want to be in a position to say that I was at a hearing in Hawaii and the SBA District Director there indicated that he was short on personnel, short on budget; this would then permit me to ask the Administrator why he has not requested more in his budget.

You see what I mean?

Mr. MITCHELL. I follow you precisely. It may be unfair to ask the witness to give us a ballpark figure, and certainly we are not talking about unlimited resources. But I think the committee would appreciate if you would at some time in the future send us a conservative estimate on what you would need in terms of additional resources to do a better job. Would you be able to do that?

Mr. NAKAGAWA. I would be happy to do that, Mr. Chairman.

Mr. MITCHELL. The reason I am so interested in that is that you are relying heavily on the banks that are already established in the various parts of the area, and yet in your testimony you have indicated that you encounter unique problems with the banks in packaging SBA loans.

If you are having problems, why would you rely heavily on some entity that is giving you some difficulty? What is the nature of the problem that you experience?

Mr. NAKAGAWA. To start with, the problem begins with the small business concerns out in the Pacific Territories. In many cases, they do not have financial statements. Their business records, if any are kept, are in complete disarray. So trying to put together a credit situation under those circumstances is a very difficult process.

Mr. MITCHELL. That is not the problem with banks.

Mr. NAKAGAWA. Not with the banks.

Mr. MITCHELL. That is with the small business itself.

Mr. NAKAGAWA. It is the problem the banks encounter in trying to get the small business people to provide the kind of financial data and information on which they can make an intelligent judgment. That basically is the problem.

Mr. MITCHELL. Between SCORE and your other offices, don't you sort of review the package before they go to the banks?

Mr. NAKAGAWA. The banks do it first. We review after the banks package the loans.

Mr. MITCHELL. I have only two more questions. One of the big problems that I encounter with small business loans all over the country is the length of time that it takes to put the package together. We have two problems: One, the length of time in getting an 8(a) certification. The Administrator of SBA said they can do it in I think something like 6 weeks, but we have found it to be as much as 9 months where a guy has been out there hanging, not knowing whether he is certified or not.

We have the same problem in terms of packaging. What is the length of time it takes to put a package together and get final approval on it? What is the average?

Mr. NAKAGAWA. I think our chief of finance has these statistics.

Mr. MITCHELL. Is he here?

Mr. NAKAGAWA. I will ask Mr. Thome to respond to that question.

Mr. THOME. Mr. Chairman, the actual processing time for direct loans ranges between 13 and 16 days. The actual time it takes to have us receive it in its finished form, I don't have that information.

Mr. MITCHELL. I am much more interested in the bank participation loan.

Mr. THOME. The turnaround time for all of our loans, including direct loans, is 6 days.

Mr. MITCHELL. Six days?

Mr. THOME. Yes. That is the average for all the loans we receive, which includes direct loans, which you have to realize we don't have that many direct loans in our portfolio.

Mr. MITCHELL. That is preparation to finalization?

Mr. THOME. That is the actual processing time for the loan when it comes to our possession until the time we have responded to the applicant or the bank.

Mr. MITCHELL. That is an admirable record.

What I am trying to get at is some guy comes in to SBA and says, "I want to put a package together; can you give me help?" And you assign a SCORE person to work with them, or somebody else. What is the length of time to put that package together?

Mr. THOME. I don't have that information readily available, but I would be happy to provide it.

Mr. MITCHELL. Does anyone know?

The problem is if it takes an undue length of time, human beings are impetuous people, if you have 5 or 6 months' lapse, the guy is losing interest, even though you can finalize it in 6 days. But if the first half takes that great deal of time, it can be a discouraging factor.

Mr. THOME. I believe the district director has approached that problem. As he mentioned in his testimony, he has been attempting and has actually accomplished the loan packaging clearinghouse arrangement, which is to shortcut these times.

Mr. MITCHELL. That is exactly why I raise the question, because you brought it up in your testimony.

Mr. NAKAGAWA. Yes.

Mr. MITCHELL. When you brought it up, it suggested to me there had been some problems in terms of the length of time to put a package together. Otherwise, you wouldn't have put this new entity together.

Mr. NAKAGAWA. Mr. Chairman, Mr. Evans will be testifying in a little while here, and he can, I am sure, give you a lot of information on the packaging time and problems that he is faced with.

Mr. MITCHELL. My final question—and I don't want an answer today—but this is really where we need help, and at some time in the future I would like for you to submit to me your ideas on the following problem area.

There appears to be an increasing problem with reference to the size of small businesses and the requirements of Federal agencies of those small businesses. As you know, a small business can have 500 employees and can gross several million dollars and still be classified as small. On the other hand, if you have some of the shops I have seen in and around the hotels of one- or two-person operations, the requirements on them are the same as the requirements on a person employing 500 people. I understand that IRS makes the same requirements, the Environmental Protection Agency makes the same requirements, SBA makes the same requirements.

I have been toying with the idea of making a distinction between a small, small business and small business. The average shop that has three people—husband, wife, and son—working in the shop. I don't think they should be required to fill out the same forms that a company does which has 500 employees.

So toy around with that idea. It is going to be hard to come up with a categorization, but I think it is important. If you are selling jewelry and you have to close down the shop for 3 hours to fill out the forms IRS sent you, you lose money. You don't have a CPA to do that if you have a little three-person operation. So give some thought to that, of how we might achieve equity in size.

We thank you, gentlemen. We hope you stay for the rest of the time.

Our next witness is Kent M. Keith, director of the department of planning and economic development. Thank you, Mr. Keith, for being here. On your way up, let me advise you that we have copies of your testimony and all written testimony will be submitted in its entirety for the record. Since it is rather voluminous, would you submit it for the record and give us the highlights.

TESTIMONY OF KENT M. KEITH, DIRECTOR, DEPARTMENT OF PLANNING AND ECONOMIC DEVELOPMENT, OFFICE OF THE GOVERNOR, STATE OF HAWAII

Mr. KEITH. Thank you, Mr. Chairman.

Good morning, Mr. Chairman and members of the committee. I am Kent Keith, and I serve as the director of planning and economic development in the cabinet of Governor Ariyoshi.

With your permission, I would read the shorter statement of the Governor and then make a few comments based on my longer written statement.

Mr. MITCHELL. The longer statement will be submitted without objection for the record.

Mr. KEITH. The statement of Hon. George R. Ariyoshi, Governor of the State of Hawaii reads as follows:

PREPARED STATEMENT OF HON. GEORGE R. ARIYOSHI, GOVERNOR, STATE OF HAWAII

Mr. Chairman, members of the committee, I wish to express my sincere thanks and appreciation to the Committee on Small Business for coming to Hawaii to give our citizens the opportunity to testify on this important subject.

Small business holds a very special value for me.

When I was growing up, my father and mother ran a laundry in Kalihi, and I remember well delivering that laundry when I was a young boy. Later, when I returned from law school, I helped my parents with the management of the business. That experience taught me many lessons and many values, and those memories and impressions will remain with me for a lifetime.

I believe I know what a small business represents, with all its uncertainties and anxieties. I certainly recognize that small businesses are the backbone and the stabilizing influence of our economy.

If ever there is a place in the United States where small businesses form a substantial part of the community, it is in Hawaii. The numbers tell the story. Census Bureau figures indicate that there were more than 21,000 business establishments in Hawaii as of March 1981.

Some 95 percent of these businesses had fewer than 50 employees. More than half had four employees or fewer. Only 45 companies had more than 500 employees.

In addition to those businesses with a taxable payroll, there were an additional 45,000 business entities that filed returns with the Hawaii State Department of Taxation. This means that Hawaii supports a total of 66,000 business entities. This is disproportionate to Hawaii's population, even when adding the 100,000 visitors in Hawaii on an average day. It means that Hawaii has a licensed business unit for every 15 persons in the total population mix.

These statistics describe Hawaii's vigorous small business community. We have an active population with a strong entrepreneurial spirit.

Most jobs created in our community are not in a new or unique activity, but rather result from employment expansion in our existing small businesses. Nationwide, small businesses account for as much as 80 percent of all new jobs. So, while we must seek new industry, we must also strengthen what we have, so what we have will prosper and grow. Our State administration recognizes that small businesses are the key to expanding Hawaii's economy. In recognition of this, we have taken direct action to alleviate many of the problems facing legitimate small business operations.

Permit me to review some of the actions we have taken to support small business enterprise in our islands.

We have created a new position and will be appointing a new deputy attorney general to address various problems that plague small businesses. For example, we have a proliferation of products manufactured elsewhere which improperly carry a "Made in Hawaii" label.

Mr. MITCHELL. Why don't we just lock those people up?

Mr. KEITH. We feel we have the statutes to do that.

Mr. MITCHELL. You can't play trickery on the public without paying the penalty.

Mr. KEITH. Unfair and deceptive trade practices must be curbed. We expect that there is more to be done than one person can accomplish, but we want to move forward.

I have appointed a 13-member small business advisory committee composed of members from both the State and Federal Governments and from the private sector. The basic purposes of this committee are to promote communication and dialog with the legislative, executive, and judicial branches of government regarding the problems of small businesses; to identify and evaluate problem areas; to stimulate expansion of small business activity in the islands; to identify government resources useful to small businesses; and to recommend ways government can further assist such businesses.

In addition, I have appointed a second committee, the Governor's Committee on Doing Business in Hawaii. This group has completed its report, which identifies Hawaii's strengths and weaknesses as a place to do business. The committee recommended, in priority ranking, how we should better use our strengths and overcome our weaknesses.

A third group I have appointed is the State Tax Review Commission. Its purpose is to evaluate thoroughly the State's tax structure and recommend tax and revenue policy changes which would moderate, or eliminate, any tax inequities that may have developed over the years.

Small businesses in Hawaii support our major economic pillars of tourism and defense activities. Tourism, which generated $3.7 billion in income last year, provided 161,000 jobs in 1982. Of those, 88,900 were direct jobs, while 72,00 were indirect. Many small businesses are involved in both categories. The same is true for the support services our civilian economy provides to the military.

We have placed strong emphasis on assisting the growth of diversified agriculture. Many small businesses are involved here. We can be very pleased with the progress of our macadamia nut industry; our fruit production, including guava and papaya, which increasingly are finding world markets; and our flowers, foliage, and potted plants which are highly attractive in both mainland and foreign markets.

Diversified agriculture, including livestock and poultry, has tripled in the last 12 years, from $60 million to $190 million in annual revenues.

To support our small manufacturers, Mrs. Ariyoshi and I have participated directly in Hawaii promotions at mainland department stores. I can testify personally to the value of such government-industry cooperation to promote both Hawaii products and our tourism industry.

Additionally, we have supported efforts to attract high technology activity to Hawaii. We prepared a Hawaii high technology development corporation, and a research base in the form of the Pacific International Center for High Technology Research is being established at the University of Hawaii. We seek imaginative, innovative, far-seeing entrepreneurs who have the insight and wisdom to appreciate and utilize Hawaii's unique resources. There are already a dozen small businesses in the high technology area in Hawaii. We are encouraging them, because we see many niches for small businesses in technological development.

It has long been recognized by our State and Federal Governments that an integrated approach must be taken in assisting small businesses, to provide the environment in which they can develop and expand.

In the past, we have participated in partnership with the Federal Government in Economic Development Administration and Small Business Administration programs which have been directly beneficial to small business in Hawaii.

Hawaii is unique among the States in that it is surrounded by the Pacific Ocean and is some 2,500 miles from its nearest market, the west coast of the United States. While it is understandable that Federal programs to assist small business have a general applicability to all States, we urge the committee to take into consideration the unique problems faced by Hawaii's small businesses as they seek to compete in overseas markets.

Small businesses deserve our support. They are run by people who have an idea or a dream, and put their time, money, and reputation on the line to make that idea or dream come true. It is a difficult challenge, filled with risk of failure, with its immediate personal impacts. When small businesses succeed, they provide jobs, create new products and services to meet human needs, and generate tax revenues for health, education, and social services. Our economic success depends on the success of small businesses. We will appreciate all the help which the Federal Government can give to our small businesses in Hawaii.

Thank you for the opportunity to provide these comments.

Mr. Chairman, that was the statement of the Governor.

Mr. MITCHELL. Yes.

Mr. KEITH. If I might comment on the written statement which we have delivered to you under my name. Generally, we believe that in our department of planning and economic development, in our role of promoting economic development, there are two key areas and these are money by way of loans, and information.

In the testimony, we outline the different types of loan programs that we have. We have a capital loan program under which we have expended about $12.5 million, and we have been able to attract additional moneys so the total program is worth about $39 billion. We have about 190 loans we have made in that one program. Our guesstimate is that it has generated 1,000 jobs. We are still collecting data. We have about 50 percent of our recent questionnaires back in hand and that shows about 570 new jobs so far in that program.

The department of agriculture has an aquaculture loan program. They have made 17 loans totaling $700,000.

We have two fishery loan programs. We have made 33 loans for large fishing vessels, that is about $4.8 million altogether. And there are 44 small fishing vessel loans, about $1 million in that category.

The department of agriculture has provided 3,774 loans, about $42 million, to local farmers since 1974.

So in agriculture, fisheries, and capital loans, we have been pushing the direct loan program.

We think that we not only get most of the money back, but by creating the new jobs, we generate new tax revenues and multipliers in the economy. The data I don't have yet, but we are trying to develop for our purposes here is data which would show how much money comes back to the government as an investment through these direct loans. My guess is that $2 or $3 will come back over time for every dollar based in that program. It is a revolving loan program. We are trying to determine how many years it takes for that payback.

In the information area we have this past fiscal year obtained the Governor's approval to reprogram some funds and we have transferred them to the chamber of commerce for use in their small business center. This was sort of an emergency measure because this small business center was funded with CETA funds and it did not appear to us it could be completely funded with Job Training Partnership Act funds and we stepped in with $76,000 to keep that going.

There are people today from the chamber who can explain that program to you.

We have worked with our manufacturers and product promotion programs. We estimate $400,000 devoted to our promotional programs in the last 2 years; 117 jobs were created. We believe the sales that resulted came to $5 million and that 50 companies established 62 new markets throughout the country.

We have a foreign trade zone operation. We have an international services agency and these are geared toward information and promotion.

In the testimony, we have four suggestions, some of them still to be developed. The first is we would like to see educational programs and we would like to see more direct loans by the Small Business Administration.

Second, in looking at the information need, it has been suggested that there is a need for a one-stop information center and we are looking into that for our department to see if we might assist.

We suggest there may be areas where the Federal and State Governments can work with our people to promote products to foreign customers overseas. This is a special need of our State because we are geographically isolated.

Primarily that is a cost problem. There are good programs but if it costs $2,000 or $3,000 to rent a booth, for example, this may be too large an entry barrier to our small businesses.

Finally, there are a few things we are concerned about such as the exemption of Hawaii and other Pacific islands from harbor-use fees. Of our goods 97 percent come in by ocean freight and we would be disproportionately taxed if the harbor fee regime went into effect.

In relation to our isolation, I must say I am concerned about the impact that we would face in the event of a cutback or cutoff in oil supplies. We are doing work on the possibility of a strategic reserve or reserve within the State to keep our economy going. The possibility of shipping interruptions, of course, also may lead to small business people keeping larger stocks on hand than those in other parts of the country which is an additional cost of doing business here.

Mr. Chairman, that is a comment on the larger, longer written statement that you have before you.

Thank you.

Mr. MITCHELL. Thank you very much for the Governor's statement and for your statement.

[Mr. Keith's prepared statement follows:]

PREPARED STATEMENT OF KENT M. KEITH, DIRECTOR, DEPARTMENT OF PLANNING AND ECONOMIC DEVELOPMENT, OFFICE OF THE GOVERNOR, STATE OF HAWAII

Mr. Chairman, Members of the Committee, I appreciate the invitation to appear before your "Committee on Small Business" to report on small business in Hawaii and its needs.

Small business in Hawaii can be characterized as truly small, with the great majority of our business establishments having four persons or less. Small businesses here are isolated from major markets and are in competition with both foreign and domestic producers who have the advantage of economies of scale. Many small businesses in Hawaii begin by catering to local residents, tourism and defense-related markets and after growing to a size to serve those markets are stifled from further growth by the cost of competing in Mainland and other overseas markets.

The State of Hawaii recognizes the importance of assisting small businesses in Hawaii to grow because we must increasingly rely on this sector to create the jobs needed by a growing population. This is particularly true since the sugar and pineapple industries, which have been mainstays in Hawaii's economy, are in difficult straits and may decline.

Furthermore, the State is committed to improving the climate for small business enterprise in Hawaii through support of its existing productive enterprises and through its efforts to diversify the local economy by developing new "preferred growth" industries such as aquaculture, diversified agriculture, motion picture and television production, high technology manufacturing and services, commercial fisheries, and international trade and commerce. Much of this is done by the Department of Planning and Economic Development (DPED). Economic development work is also done by the Department of Land and Natural Resources and the Department of Agriculture. The total amount spent by all State government agencies in 1981-83 on economic development related activities was $76.5 million. This is proof of a strong commitment to the success of business in our State.

The Hawaii State Plan, the only legislatively-adopted comprehensive State Plan in the nation, was signed into law in 1978. Contained within that Plan are 51 policies which guide State government activities in support of the economy and economic development.

The role of DPED is to promote business. Our statutory mission is "to stimulate through research and demonstration projects those industrial and economic development efforts which offer the most immediate promise of expanding the economy of the State." We are pro-business.

Since we are an insular community, the State has recognized the need to assist small business in the financing of their operations and in the development of new markets. Twenty years ago, the Hawaii Capital Loan Program was established to assist small businesses in obtaining financing not available at banks and other financial institutions. Loans are made directly or in participation with banks and other financial institutions. Since the inception of the program, some $39.6 million has been loaned through this program with the State's participation of some $12.5 million of the total. There are currently 134 loans outstanding to small businesses through this program. Some 29% of these firms have a delinquency rate of over 90 days. We are currently surveying loan recipients and to date, we have found that some 570 new jobs have been directly created by this program over the last 10 years. The reported number of new jobs created represents approximately 50% of the total questionnaires sent out.

The State has invested $2.7 million in its Aquaculture Development Program with significant results. Acreage in aquaculture has nearly doubled from 234 acres in 1976 to 456 acres in 1980, and total revenues have grown from $200,000 to $1.7 million over the same period. The Department of Agriculture's Aquaculture Loan Program has granted 17 loans providing $703,000 to producers of aquacultural products in Hawaii. State assistance helped prawn farmers produce more than three-quarters of a million pounds of prawns between 1975 and 1978.

The State of Hawaii and the private sector are working together to help small businesses through the Chamber of Commerce Small Business Center. The State, in October 1983, provided $76,000 in matching funds to the Chamber of Commerce of Hawaii to continue the operation of the Center which helps small business to survive and expand. The Center established an entrepreneurship training program in 1982 in response to demand for a practical, comprehensive and moderately priced course that would prepare participants to plan and run a business. In addition to entrepreneurship training classes, the Small Business Center also offers monthly business seminars, consulting services, financial management assistance, and a loan packaging service. It strives to be a one-stop shop of information, and it provides direct assistance to small business in Hawaii.

With the active support of the State, diversified agricultural revenues have grown from $22 million in 1970 to $91 million in 1980, over 300%

growth. Over the same period, sales of Hawaii-grown milk, eggs, and livestock increased 93% from $42.1 million to $81.2 million.

A total of 3,774 loans have provided over $42 million to local farmers since 1974, including 92 loans providing over $4 million under the innovative New Farmers Program.

The State has also supported the development of Hawaii's marine resources. The Hawaii Fisheries Development Plan was prepared to guide the future development of commercial fishing in the Islands. Since 1972, 33 large fishing vessel loans totaling $4.8 million and 44 small fishing vessel loans totaling $1 million have been arranged to revitalize Hawaii's fishing industry. The State portion of loans granted under the two programs totaled $4.5 million and leveraged an additional $1.3 million in private and Federal capital.

In addition, DPED has been assisting small manufacturers in marketing their products through product promotion programs. These efforts include trade shows, department store, shopping center and supermarket promotions and trade advertising. Examples of the success of the combined efforts of DPED and small business are the successful storewide "Department Store Hawaii Promotions," undertaken in the past and planned for 1984. Recent stores included: Garfinckel's, Washington, D.C.; Zions Cooperative Mercantile Institution, Salt Lake City; Frost Brothers, San Antonio, Texas; Gottschalks, Fresno, California; Craig's, Houston, Texas; and Jacobson Stores, Jackson, Michigan. Being planned are promotions with Bullocks Wilshire, Palm Springs, California; Harris' Department Stores, San Bernardino, California; and the largest department store group in Hong Kong, the Wing On Company. As an example, the potential for this promotional event is evidenced by total purchases of Hawaii products which amounted to approximately $300,000 in wholesale value by the Gottschalks Department Stores for their two-week Hawaiian promotion held in April 1983.

State of Hawaii and local business joint participation in selected local and Mainland trade shows has also proven to be effective. In the past, DPED has helped to offset costs involved with participating in Mainland trade shows by reimbursing locally based companies for part of their booth rentals and transportation costs. Trade shows have provided companies with an opportunity to expose their products to thousands of buyers, wholesalers and distributors. We hope to be able to continue this type of promotional activity.

Incomplete results from a current survey of manufacturers show that with an expenditure of some $400,000 in the past two years, 117 new permanent jobs have been created, and sales have increased some $5 million as a direct result of State efforts. New markets have been established for 50 companies in 62 markets throughout the U.S.

The State of Hawaii believes that Hawaii's future and the Nation's destiny are linked to the development of international trade and commerce in the Pacific Basin.

Hawaii operates one of the best Foreign Trade Zones in the United States. Hawaii's Foreign Trade Zone No. 9 received a Presidential Award for excellence in 1979, and handled over 11,272 tons of merchandise valued at $46,187,741 in fiscal year 1981 alone.

The Hawaii International Services Agency (HISA) provides information to overseas investors on opportunities in Hawaii, and represents the State in overseas trade fairs and conferences. The State has successfully encouraged

13 companies to establish regional headquarters in Hawaii over the last two years.

The Federal government has helped many of Hawaii's small businesses through the Small Business Administration's loan guarantee programs and Small Business Investment Companies (SBIC's). In Hawaii we will soon have three SBIC's. One, pending SBA approval, will be called "Bancorp Small Business Investment Co., Inc." This new firm will be a subsidiary of Bancorp Hawaii, Inc., the parent company of the Bank of Hawaii.

The Federal government is also assisting Hawaii through the International Trade Administration District Office in Honolulu. This office assists and encourages our local manufacturers in exporting their products and provides regular workshops and seminars to educate our business people on the opportunities available to exporters.

The Federal government's Trade Adjustment Assistance Program has assisted Hawaii manufacturers and contractors adjust to business problems caused by competition from imported products. This program, authorized by the Trade Act of 1974, is based at the University of Hawaii.

There are four areas which I would like to suggest that the Federal government might further assist Hawaii's small businesses:

1. Educational programs to assist in the establishment of venture capital companies and increased capability by the SBA for small business loans. Hawaii's small businesses are in great need of additional venture capital. Traditionally, Hawaii has been an importer of vast amounts of capital investment to finance our hotel plant and related recreational activities. We do not have a tradition of much industrial activity--other than agricultural processing--and most of our local investors have invested in

real estate development. As demand for venture capital in high technology and other small business enterprises grows, we face a void in assisting such expansion.

It is vital that Hawaii's business community be made aware of the considerable opportunities available through the establishment of private venture capital companies. The Federal government could help us in redirecting the flow of this venture capital to small business by sponsoring conferences, workshops and seminars that would bring experienced venture capitalists and investment bankers to Hawaii to educate and assist our businessmen in the formation of private venture capital companies. This would enhance our opportunities to attract high technology to the State, and assist existing small businesses to expand.

In addition, we recommend that the Small Business Administration be given increased capability and funding for direct loans. This would give us the opportunity to participate jointly with the SBA in making loans and increase our mutual capability of providing needed financing for small businesses.

2. There is a need for information for businesses in Hawaii about opportunities and trends. Although there are currently numerous sources of relevant and vital information contained in massive data banks within State and Federal domains, there is no one-stop information center to give business people the kinds of information they need to conduct analysis of the business environment in Hawaii and target markets overseas. The limited size of the business population in Hawaii prohibits the private sector from tackling this need due to the relatively small market for the information. An information center located in Hawaii could, however, have favorable implications for trade

throughout the Pacific Basin. It is envisioned that the State and Federal governments working together could accomplish this task most efficiently.

3. Cooperative Federal-State product promotional efforts. We invite the Federal government to join us in promotional efforts to promote Hawaii-made products overseas. Since many of our businesses have been impacted by Federal decisions allowing low cost foreign competition, we suggest that this effort can be directed at both Mainland and foreign overseas markets.

There is a need for cooperative efforts between the State of Hawaii and the Federal government to assist our small business exporters in finding foreign customers. Both the U.S. Department of Commerce and the U.S. Department of Agriculture are constantly putting on trade fairs, special exhibits and trade missions worldwide. Hawaii companies take advantage of these events and find them good for business. As an example, five Honolulu companies are now preparing to participate in a Commerce Department trade mission to Southeast Asia for architecture and construction engineering services.

The principal problem we see with such missions and fairs is that the costs are too high for many of our small exporters. Commerce is sponsoring a U.S. apparel exhibit in Tokyo in February, and yet the booth costs of $2,500, coupled with transportation and living expenses, make it virtually impossible for our small manufacturers and designers to show their goods.

We know from sales in Waikiki that our apparel will sell well in Japan, but we can't seem to get our small exporters to the Japanese markets. A grant program should be considered to lessen the cost of overseas trade events for small business exporters.

We know that cooperative efforts can work to the benefit of small businesses in the State of Hawaii and the Pacific. For instance, the Pacific Basin Development Council (PBDC), headquartered in Honolulu and jointly funded by the U.S. Department of Commerce (through the Economic Development Administration), and the State of Hawaii and the Territories of American Samoa, Guam and the Commonwealth of the Northern Marianas, mirror the combined efforts of the Federal and Island governments in pursuing economic development. This effort is centered on permanent job and revenue creation in the Pacific Basin, and by the nature of its membership, places a high priority on small business development.

Efforts in this area include the exploration of foreign markets for U.S. Island and Mainland products. Governor Ariyoshi served as the first president of PBDC and continues to support this unique, integrated approach to economic and business development in the region.

I have alluded to Hawaii's unique geographic location and our small pocket size market which limit expansion and place Hawaii's small manufacturers at a disadvantage when competing with their Mainland counterparts. Hawaii's businesses often look to overseas markets, but except for situations where production inputs are unique to Hawaii, Hawaii's businesses are not in a favorable competitive position because of the cost of reaching those markets.

While direct subsidies to alleviate freight costs may not be feasible from either a Federal or State view, there may be other actions that can be taken to assist our small businesses in selling overseas.

4. Exemption of Hawaii and other Pacific Islands from harbor user fees. I would like to point out an inequity to Hawaii which results from our

unique location and dependence on ocean transportation. This is the Federal government's efforts to redistribute the costs of government harbor services, placing the responsibility on the beneficiaries of those services through port user charges. As the only State with no land-based alternative to interstate commerce and which receives 97 percent of its goods by ocean freight, Hawaii's small population would be disproportionately taxed by harbor fees and would experience considerable rising costs across the board. I strongly urge the Federal government to exempt Hawaii and the other U.S. Flag Pacific Islands from imposition of user fees on their respective harbors.

I appreciate this opportunity to present testimony. Thank you!

Mr. MITCHELL. I am very, very pleased to learn about HEDCO. I think that is a development that is taking place in many of the large metropolitan areas. In my own city of Baltimore, we have BEDCO, the Baltimore Economic Development Company. I think the States have to start meeting an increasing responsibility in terms of helping small businesses.

Are the HEDCO funds all public moneys?

Mr. KEITH. Mr. Chairman, I am not sure to which part of the testimony you speak to.

Mr. MITCHELL. I am talking about the loan programs.

Mr. KEITH. We operate the loan programs out of our department directly. That is in addition to the HEDCO.

Mr. MITCHELL. Are these funds all public funds?

Mr. KEITH. Yes; they are State Government funds. What we have found is by designing the program where we are a lender of last resort, we have, in fact, been able to attract and have been a magnet for other funds and most of our loans end up having some private money, Federal moneys, and State moneys together.

Mr. MITCHELL. That is what I wanted to encourage because it seems to me the private sector has an enormous stake in this. If you are generating jobs and consumer purchasing power and that power spills out to all parts of the economy, I would hope you would continue to explore the possibility of a greater infusion of private money mixed with your State funds. Obviously you want to expand your program.

How long have these loan programs been in effect?

Mr. KEITH. The capital loan program has been in effect for nearly 20 years.

Mr. MITCHELL. OK.

Mr. KEITH. That is our largest program. I believe the fishing vessel loan programs are more recent.

Pursuant to your last remark, Mr. Chairman, the number on my testimony shows that we put in $12.5 million but the total value of the program is $39 million. That balances private and Federal funding. Of course the banks will turn down the application the first time. They will come to us as last resort, once we show we are willing to go with them, the banks become more willing and we leverage each other up to the total.

Mr. MITCHELL. At what interest rate?

Mr. KEITH. At 7½ percent.

Mr. MITCHELL. That is not bad. You ran through a litany of figures on employment opportunities that have come about because of the loan programs. Could you give me a rough estimate on the total number of jobs that have been generated or saved because of the loan programs?

Mr. KEITH. Mr. Chairman, at this point, I only have a rule of thumb or rough estimate and that is we think we are getting 100 jobs per million dollars loaned in seven loans throughout all the programs. The data is just not available yet. Based on our capital loan program, we think we have 1,000 jobs for $11 million or $12 million. So it may come to about one job per $10,000 loaned.

Mr. MITCHELL. Which is excellent. You win on both ends. You get jobs where you increase consumer purchasing power, and you get repayment of the loan at 7½ percent interest, which certainly would sustain your revolving loan fund thus diminishing the possibility of having to go back to the State legislative body for a budget each year. It is an excellent program.

Mr. KEITH. We think it is an excellent, straightforward investment of Government money. If you invest $1, over a certain number of years you get $2 or $3 or $4 back.

Mr. MITCHELL. You were talking about the one-stop center. Have you been in touch with the business development agency?

Mr. KEITH. We have just started talking about this.

Mr. MITCHELL. It would seem to me they are very interested in one-stop information centers and it seems to me that that is an agency that should make some money available to you to at least get it off the ground.

Mr. KEITH. We appreciate the suggestion.

Mr. MITCHELL. Mr. Savage.

Mr. SAVAGE. Mr. Keith, I would like to ask a question continuing in the vein of the chairman's question, who pointed out the obvious that State programs are of concern to us to the extent that they point up the need to expand or modify or shape differently the programs of SBA since they relate to an impact on each other.

Now, your loan program seems commendable, and the promotions you mentioned, and the many committees the Governor is appointing and so forth, but what about State contracting for things you buy for road construction. Do you have any small business set aside in your own contracting totals?

Mr. KEITH. Mr. Savage, I am aware of a statute or regulation that points toward granting those contracts to small businesses within the State, but I am sorry I can't give you the statute or give you a number. I am not that familiar with it.

Mr. SAVAGE. That bothers me a bit. Obviously you do have a small business program and in fact in the Governor's statement, he talks about the development of small business as being key to your economic progress.

If that is key in your economic progress and development program, it would be most helpful to us if you would be able to indicate what contracting provisions you have particularly impacting small business and what have been the results in dollars.

As the chairman pointed out earlier, often these conferences are held but the bottom line is how many dollars can they directly attribute as resulting from the conference.

You are economic development director, correct?

Mr. KEITH. That is correct.

Mr. SAVAGE. If you are the economic development director and the key to your economic development, according to your Governor's statement, is small business, wouldn't it somehow be true that you would need to know how your State contracting benefits small business? If you don't know that, how do you know how fairly or unfairly small businesses are being treated with respect to your contracting?

Mr. KEITH. Mr. Savage, I don't disagree with you. What I am saying is I don't have that information off the top of my head. The small business advisory committee of the Governor has been reviewing that. We will be happy to provide that information to you.

Mr. SAVAGE. You are not familiar with what special provisions you have in your contracting procedures that would benefit small business?

Mr. KEITH. I believe I started answering your question by saying I have read such a provision but I can't cite it to you or quote it to you directly.

Mr. SAVAGE. I would appreciate it if you would be so kind as to provide to this committee what specific provisions you have in your procedures or your laws to serve or boost small business and to indicate to us, if it is possible, the extent small businesses concretely have benefited from it.

One other question, Mr Chairman.

In the statement of Mr. Waidzunas——

Did he leave?

Mr. MITCHELL. Yes, he just left.

Mr. SAVAGE. He mentioned this, and I am not fully familiar with the ethnics of Hawaii. It seems really to be just an ideal whole Nation in terms of your mixture and how well you get along. But he mentioned in his statement that under the 8(a) program, there were 30 firms participating, receiving Federal contracts. He said 3 were black, 2 were Hispanic, 20 Asiatic-Pacific, and 5 native Americans, and in parentheses, he says Hawaiians. I am at a loss. I thought everyone here were Hawaiians. How do you break down in the State of Hawaii the definitions or the meaning of the definition of minorities that we have set forth in Public Law 95-507? Do you see what I mean? I imagine this terminology is familiar here, but it is unfamiliar to me. Native Americans I think of as Indians, normally.

Mr. MITCHELL. If the gentleman will yield. I avoided that one myself. Who is a minority really in Hawaii?

Mr. SAVAGE. Right.

Mr. KEITH. In point of fact, we are all minorities. I really couldn't comment on the SBA definition. I am just not competent.

Mr. SAVAGE. I don't mean it in that sense. We are all minorities in one way or another. In terms of economic development, we are talking about economically disadvantaged minorities.

Mr. KEITH. I don't believe any of our programs are keyed to economically disadvantaged minorities.

Mr. SAVAGE. That is really what I was getting at because I didn't notice in your statement, nor did the Governor's mention that there was any set-aside program or what have you.

Now, I am impressed that this is just a wonderful place, but what is even more wonderful than I had imagined in my fondest dreams that we finally have found a State in our Nation, Mr. Chairman, where they have no minority economic problems. That is just wonderful.

Mr. KEITH. I don't believe that is what I said.

Mr. SAVAGE. I am more than just curious because I am from the State of Illinois and whatever you are doing, I want to take some of that back with me because my State is suffering from all kinds of minority problems. You don't have any such problems here?

Mr. KEITH. I don't believe that is what I said.

Mr. SAVAGE. I misunderstood you then.

Mr. KEITH. I believe the basis of our program is that someone who wants to start a small business and has been turned down by banks and needs a lender of last resort comes to us and we deal with them on a first-come-first-served basis.

Mr. SAVAGE. That is not what I am getting at. Not your small business program totally, I am talking about what aspect in there do you have to provide for economically disadvantaged minorities if you have any in Hawaii. Do you have any? I guess that is the first question.

Mr. MITCHELL. If the gentleman will yield. Maybe I can help out just a little bit on this.

In terms of State procurement in many States, there is a set-aside for what is called socially or economically disadvantaged people. That is to assure that American Indians get a part of State contracting; that Hispanics do; that blacks do, et cetera. I guess if I read you correctly, you want to know is there any similar arrangement in the State of Hawaii for those persons doing business in terms of procurement and contracting.

Mr. KEITH. There may be, Mr. Chairman, but I am not aware of such a program.

Mr. MITCHELL. All right.

Mr. SAVAGE. I am asking, Mr. Chairman, because it relates to our own programs here, because in the statement of Mr. Waidzunas, I thought he was properly boastful of the program, that he had an 8(a) program that grew from just a handful of firms, 18 firms in 1975 to 30 firms today and indicated that they have a total volume of $10.5 million.

Now, if there are no such disadvantaged firms here, I am wondering what happened to our $10.5 million through SBA in the 8(a) program and if that money was not thrown away, then of course I am bothered if the State does not recognize the existence of disadvantaged, economically disadvantaged minority owned businesses.

Mr. KEITH. Mr. Savage, I believe the question hasn't really arisen in our Department because we have been able to service nearly everyone who applied. We have not had to say we can only service one in three so we will focus on specific disadvantaged groups.

Mr. SAVAGE. I am happy to recognize this is the only State that I know about in the United States where there has been no need to have special programs to provide for the historically disadvantaged minority businesses.

Mr. MITCHELL. Thank you.

Mr. KEITH. I don't believe my statement implies there is no need. What I am trying to describe is we believe we have been servicing those who have come forward. It may be on review there is some need. I believe I am getting something back from you that I didn't intend to say.

Mr. SAVAGE. I think maybe we are missing just a bit. What I am getting at is where we have found economically disadvantaged minority business, the whole reason for our set-aside program is that we have found before and even in the process of the program, that where such businesses existed it existed due to no fault of the ownership but out of historically evolved discriminatory and limiting circumstances. So we found that in the normal process of doing business that these minorities would be shut out and not been given a fair share or fair opportunity. That is the basis of much Federal legislation.

That is the basis of continuing acceptance of amendments to Federal laws providing for 10 percent set-asides, it is almost established, blacks, Native Americans, Hispanics, for instance. Now we have found that and the starting point to be wrong.

The starting point to correct it has been to identify these minorities and then, No. 2, to provide special arrangements. That is why I asked the question.

Mr. MITCHELL. I would think that maybe we can double back to this and get our SBA people back toward the end because obviously if they are providing 8(a) assistance, they are doing so within the definition that has been established for socially and economically disadvantaged folks at the Federal level. So we can bring them back up.

Mr. SAVAGE. Yes. Thank you very much.

Mr. MITCHELL. Congressman Akaka.

Mr. AKAKA. Thank you very much, Mr. Chairman.

I just want to make some comments here. One is to convey to the Governor our thanks for his excellent statement this morning; and also to thank you for your excellent statement and your answers to questions here. We thank you for your four areas of concern. The one on harbor user fees has received attention in the Congress, and it is the kind of attention for problems Hawaii would suffer in case this was imposed upon us.

I want you to know that we have worked with Chairman Bob Roe on this. It has not been conclusive, but I want you to know they know of our problems. I have received favorable replies from him in acknowledging our problems. We hope that when this is finalized some concern will be given to the problems that we have.

Mr. KEITH. Thank you. I am glad to hear that.

Mr. MITCHELL. Congressman Hayes.

Mr. HAYES. I think both statements have been quite comprehensive and deserve more than just a fleeting look, so I am going to study them and look at them. I don't have any questions at this time.

Mr. MITCHELL. Thank you very much for your excellent testimony, Mr. Keith. You are doing what I think is absolutely essential here in Hawaii. There is no doubt in my mind, and all the Federal people are going to yell and scream when I say this, but there is no doubt in my mind that there is an increasing trend on the part of the Federal Government to withdraw from full support for small businesses. It is being evidenced every day in Washington and more and more that burden is going to be thrust upon the State and I just commend you for what you have done up to this point.

Thank you for taking time out of your schedule to be with us.

Mr. KEITH. Thank you, Mr. Chairman.

[The information referred to above follows:]

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1983

February 14, 1984

The Honorable Parren J. Mitchell
Chairman
U.S. House Committee on Small Business
2361 Rayburn House Office Building
Independence Avenue between South Capitol Street
and First Street, S.E.
Washington, D.C. 20515

Dear Representative Mitchell:

As indicated to you at the hearing before the Committee on Small Business on November 28, 1983, the Department of Planning and Economic Development has developed economic benefits information on our loan programs, which we would like to share with you.

The State presently offers assistance to small businesses through several loan programs, one of which has been operating since 1964. The programs provide access to capital for the expansion of local businesses when private sources are unable to assist, but the enterprise and the proposal appear sound. The four programs administered by DPED have provided, through revolving funds, almost $20 million in State financing with a total appropriation of $9 million. Using State money as a magnet to attract private and Federal funds, more than $49 million in loans have been made.

The value of these loan programs may be demonstrated by considering the impact of the Hawaii Capital Loan Program (HCLP) in comparison to its costs. A 1983 survey of 220 current and former HCLP clients showed that about 1,350 jobs were directly created by the program and another 1,200 jobs generated through indirect and induced employment. It was also shown that the increased economic activity caused by this loan program generates in the neighborhood of $4 million annually in added State taxes. This compares quite favorably with the 1983 costs of servicing the HCLP, as well as our Large and Small Fishing Vessel Programs and our Disaster Loan Program, which incurred costs of some $145,000 ($95,000 for personnel; $15,000 for supplies, equipment rental, postage, etc.; and $35,000 in defaults). Considering both the $3.8 million revolving fund appropriation and the approximately $1.2 million in other expenses over the life of HCLP, it has aided in the creation of one job for each $2,000 spent.

The last State appropriation to the HCLP revolving fund available for loans was in 1980, and the fund is now self-renewing through interest payments and payments on principal. Interest payments of $300,000 in 1983 were double the administrative costs of the whole program. The loss rate for the program is 2.4 percent, which is similar to that expected by commercial institutions in spite of the greater risk involved.

I appreciated the opportunity to testify before your Committee and would be pleased to provide additional information as needed.

Very truly yours,

Kent M. Keith
Kent M. Keith

Mr. MITCHELL. Let me explain the format we tried to set up. We tried to get some of the governmental agencies on first so that some of the small business persons here could hear what those agencies are doing. Now we want to hear from some of the small businesses themselves and then we will double back to either agency people or quasi-agency people.

Our next panel will consist of Mike Kido, president, Construction Industry Legislative Organization; Robert Rask, president, R. Electric, Inc.; and James E. Belmont, president of the Hawaii Pipe and Supply. There are two more we would add to that: Douglas E. Luiz, executive president-secretary, M. Wantanabe Electrical Contractor, Inc.; and Wally Miura, president, Wally's Flooring, Inc.

Gentlemen, I am sorry we are costing you money. Every time a small business person leaves his business, we cost you some money but it is so important we hear directly from you and it is obvious that I would suspect most of you here fly to Washington on a regular basis and I would further assume most of you are not represented by a lobbyist or lawyer in Washington that you pay $48,000 a year.

So it is important we hear directly from you.

We will start off with Mr. Kido.

TESTIMONY OF C. MIKE KIDO, PRESIDENT, CONSTRUCTION INDUSTRY LEGISLATIVE ORGANIZATION, INC.

Mr. KIDO. Thank you, Mr. Chairman, members of the Small Business Committee of the U.S. House of Representatives.

May we respectfully submit our written testimony on the three topic areas?

Mr. MITCHELL. It will be submitted for the record and the same applies to all the witnesses. If you have your written testimony, it will be submitted for the record and will be printed in the record and you can just give the salient points you would like to make.

Mr. KIDO. Before I go further, if I may, just from a recognition standpoint of identifying the panelists for you, on my right is Mr. Wally Miura. On my left is Mr. Allen L'Espanos, resource person from the General Contracts Association of Hawaii. The other people are Jim Belmont of Hawaii Pipe & Supply, and the far left is Doug Luiz from A-1 Hydro. Mr. Bob Rask sends his regrets; he had a minor problem with some papayas being chilled in Kauai and was unable to be here.

Mr. MITCHELL. Obviously that takes precedence over this committee hearing.

Mr. KIDO. The three topics we wish to comment on are prompt payment on the part of the Federal Government; item two is inherent disadvantages of local contractors bidding on Federal works; and three, minority set-aside programs for construction industries.

In order to promote dialog, if I may, Mr. Chairman, with your indulgence, just permit the panelists to comment on the individual areas. In the area of prompt payment, if Mr. Belmont could lead off.

TESTIMONY OF JAMES E. BELMONT, PRESIDENT, HAWAII PIPE & SUPPLY CO.

Mr. BELMONT. Thank you, Mr. Chairman and panel members.

Mr. Kido has asked me to talk about prompt payment by the Federal Government. Unfortunately, that is the problem. We don't have prompt payment by the Federal Government. As I have commented in my written testimony, it becomes very difficult for small business to essentially finance the Federal Government particularly in the military area because of their very slow payment habits particularly developing more so in the last 1½ or 2 years.

The Federal Government tends to pay its bills in a manner that is becoming more and more slow and averaging about 74 days from date of delivery of material or completion of contract.

Mr. MITCHELL. The number of days?

Mr. BELMONT. Seventy-four. It is becoming more and more difficult, particularly with the what appears to be a layoff or decline in personnel within the various Government accounting offices merely by their own statements, the difficulty of processing the bulk of paperwork involved.

While we in small business appreciate the difficulty of keeping full employment in difficult economic times, the simple fact that the Government is apparently unable to process bills for payment in a timely manner puts a very difficult strain on a small business.

We are further concerned that the cash discounts which are frequently offered by people in the commercial trade to the Federal Government are not taken advantage of. That plus the interest that is beginning to be paid by the Federal Government is not paid to an extent that fairly compensates small business for its cost of carrying the Government and the loss of cash discounts that are available and the payment of interest on the money adds to the expanding Federal deficit and hurts the small businessman.

Mr. KIDO. Mr. Chairman, if ——

Mr. MITCHELL. What we will do is wait to hear from all of you and wait to raise questions.

Mr. KIDO. If Mr. Luiz would comment from the contracting end and he does maintenance work for the Federal Government.

TESTIMONY OF DOUGLAS E. LUIZ, EXECUTIVE PRESIDENT-SECRETARY, M. WANTANABE ELECTRICAL CONTRACTOR, INC.

Mr. LUIZ. Thank you, Mr. Chairman.

I would have to agree with Mr. Belmont here who is basically a supply-oriented person. We have two areas of problems: One is the general contracting work or direct contracts for construction. The other area is service and maintenance where we maintain equipment and facilities and the bulk of the work is labor oriented and we pay our people weekly.

When you have to wait 70 days to collect your money, generally with no interest on it, that is tough to operate under. We can show you records where payment comes anywhere from 60 to 75 days. Generally on contracting work, if you have the right administrator or contracting officer, you may get paid anywhere from 45 to 55 days.

Thank you.

Mr. Kido. Mr. Chairman, those two panelists will be the ones commenting on prompt payment. If you have any questions at this point, we would be more than happy to try to answer them for you.

Mr. Mitchell. Let's deal with prompt payment just a little bit. I assume all the agencies of Government know we passed a Prompt Payment Act over the protest particularly of the Department of Defense. I assume they know about it.

Let me ask you a question in terms of general contracts in construction and service and maintenance. Is it possible to draw down a portion of that?

If you have a job that, say, theoretically would take 6 months, is it possible to draw down something in the first 45 days? That is, to get some payment?

Mr. Luiz. If you have a job, say, if it is a $100,000 job, you bill in progress payments. Generally you don't wait until the end of the particular job if it is a construction-oriented job. So you bill your first payment, say, you complete 10 percent of the work and you bill the 10 percent, they take out the retention and pay you in 45 to 60 days if you've got the right administrator.

On service work, to give you an example, we generally do all the paperwork, and every time they make a change that is an excuse for us to do it over. But, say we have one in existence now, where we made a billing from September 1 to September 15, our first partial billing on a service contract.

We sent the billing on the 15th, hopefully they were supposed to process the paperwork on that first portion. At the end of the month we sent another billing in for another $30,000.

Then they start looking at the paperwork. No work was done on that first billing on September 15. I just got paid last week, Friday, for the total September billing of service and maintenance which is generally altogether.

Mr. Mitchell. You know, this is an especially troublesome area for me. I have been in Congress 14 years and I have seen some small businesses simply go out of business because the Government has not paid on time.

That is why we recently forced through the Prompt Payment Act. I think at one time HUD was the chief offender in actually forcing small businesses to go out of business, to collapse, because you don't have a reserve of capital you can fall back on. What would you recommend to remedy this situation?

Mr. Luiz. What we see is, like Mr. Belmont mentioned earlier, a constant turnover of people. For this particular service contract I am talking about, we are on our third inspector and we started the contract in March.

We have some billings from March that have not been approved, we don't get paid since March, $58,000, because we can't get the right person to make a commitment and take care of it.

Mr. Mitchell. Suppose we came up with a policy—obviously this is highly speculative in nature and theoretical—that when you submitted your request for payment it was automatically paid, then if there were any discrepancies, any problems on further review where maybe you were overpaid you would have to pay it back, would that be a feasible approach?

Mr. Luiz. Definitely.

Mr. MITCHELL. Take it on face value that the request has been submitted in good faith and it is accurate and then after you have received the payment and they review it, they can come back and say, look, I am sorry, this is where we gave you $2 too much, give it back to us.

Mr. LUIZ. I think that would be a great advantage and help us out a lot. Maybe Mr. Belmont can comment.

Mr. MITCHELL. Or any other recommendations?

Mr. BELMONT. Mr. Chairman, normally within the contract either for construction including labor or for my firm as supplier, there are delinquency provisions within the contract. If a supplier, who is by Government definition a contractor, is 1 day late the Federal Government asks for "consideration." When pressed for a definition of "consideration," we can't get a straight answer.

However, we have been told informally in delinquency hearings at Pearl Harbor Naval Shipyard that the minimum consideration of the Federal Government is 1 percent a month of the total of the contract.

However, there is no parity in reverse for prompt payment for suppliers. We have appealed this to contract administrators and we have been told if we wish to pursue it in civil court, we are welcome to do so, however, the cost of pursuing it will not make it worthwhile.

Mr. MITCHELL. That shouldn't be your responsibility.

Mr. BELMONT. Of course not, but our problem is as a small business or even if we were not a small business, the contracts are so one sided and they are pointed out to us as suppliers that we have the right to read the contract before we bid the job and if we are not willing to accept that contract, we shouldn't be participating as a bidder.

The mere fact there is provision for delinquency asking for consideration, whether the materials are required or not required, frequently where delivery from a supplier is dependent on a manufacturer such as United States Steel Corp., through no fault of ours, a shipment is delayed by a few days, a week, or a month, there is an automatic review by the Federal Government to determine if delinquency has taken place irrespective of whether the material is required for 6 more months or not.

We are immediately subjected to a penalty—you use the term loosely—we are subjected to a request for consideration, and while we do deliver the material, we have unpaid invoices in our office now in excess of 1 year old though they average 74 days.

Having provided the documentation at the time of billing with everything in full compliance with the contract, the paperwork gets lost between the inspector, the receiving agency, or bill paying agency.

Then the individual who processes the payables leaves for maternity or some other cause and we simply can't get paid. We have one invoice in excess of a year where we have faithfully and properly completed the paperwork.

Mr. MITCHELL. You don't mean to say it, but I will say it. I know one of the chief offenders is the military. I will say it. That is based on experience.

What other agencies are involved? Is this pattern followed in other agencies of Government?

Mr. Belmont. We do experience similar types of problems with all Federal agencies, but it is most particularly in the military and most significantly in the military within the Navy. The problem is an increasing problem.

It is not alleviating itself.

Mr. Mitchell. They would argue, of course, you are subject to review if you didn't get your material there on time and you say, well, the major supplier didn't deliver it to me and they will counterargue, well, you ought to stockpile it in anticipation of the major supplier not, and you countermand that act by saying we simply don't have the capital in a small business to stockpile large inventories.

Mr. Belmont. That is correct.

Mr. Mitchell. Catch-22.

Mr. Belmont. To answer your earlier question as to what recommendations we have, one would be for parity within these contracts so that if there is to be a default on the part of the contractor or supplier or delinquency requesting consideration, similarly there be more than just the interest paid by the Government for failure to pay promptly.

The Prompt Payment Act did provide or has provisions for interest to be paid on past due balances, however, if you press the individual who is determining when the clock begins, what was the effective date of the past due condition, it will range anywhere from 30 to 45 days after completion of the contract.

When you ask what is the total duration of time and at what interest rate are we paid, we have yet to ever once have a straight answer. So, if the rate of interest is supposed to approximately be 1 percent a month, however, after considering the actual period of time we are asked to hold and wait for payment, it becomes less than a one-half percent a month.

Mr. Mitchell. In other words, you want to see the Prompt Payment Act amended so it becomes applicable on the date when the contract is completed.

Mr. Belmont. The effective date of the contract completion, that is correct.

Mr. Mitchell. That is one.

Mr. Belmont. Secondarily, as in the case of Mr. Luiz' business, who as a contractor, has the ability to submit for partial payment on partial completions of labor contracts. We, as a material supplier, can bill only when total deliveries have been consummated, and no payments will be allowed or invoices submitted until delivery is completed totally.

The simple fact that a carrier such as Matson has to bump particular containers from the ship because there was no room is totally beyond the control of a supplier. It is something we cannot control and yet we cannot submit for partial payment.

Mr. Mitchell. I think I can speak for the members of the panel, we will look at the Prompt Payment Act to tighten it up. I am well aware of this.

I just bought a little gift and asked them to mail it to my Baltimore office and the lady said anywhere from 6 to 8 weeks. On a small scale, that is the same problem you have.

"The Postal Service is terrible this time of year," she says. I have heard it so many times, and we will take a close look at the Prompt Payment Act.

Mr. BELMONT. I am happy to report that the U.S. Postal Service is one of the most prompt paying of all Federal agencies.

Mr. MITCHELL. That is apart from delivery, of course.

Mr. Hayes.

Mr. HAYES. I don't have any questions. Thank you.

Mr. MITCHELL. We are just talking about this part.

Congressman Savage.

Mr. SAVAGE. Yes, Mr. Chairman.

I share the concern you are expressing, Mr. Chairman, regarding the problem pointed out by Mr. Belmont. It certainly points up inadequacies of the Prompt Payment Act that I supported. It has been very educational to hear from you, Mr. Belmont. I think it sure indicates in the next session we need to provide some legislative consideration to this problem.

We have not solved it, obviously. We ought to begin to communicate to the highest authorities, Mr. Belmont's complaint, and also indicate our support of his complaint.

If I may take a moment to thank this group because your representative, Mr. Kido, was so kind as to permit me to be his guest at church services yesterday. I was very kindly mentioned by the minister there.

I want to ask one other question on one point that bothered me here, Mr. Kido. Were you present when Mr. Keith, the State director of planning and economic development, testified here?

Mr. KIDO. Unfortunately, I was in and out of the room. Perhaps the other panelists might be able to comment on your question.

Mr. SAVAGE. Well, any of you, would you please comment. In my questioning of Mr. Keith, he indicated that the State in its own procurement procedures had no special provisions for disadvantaged minority-owned businesses and he felt that he met the needs of all small businesses so that, indeed, there was no need or is no need for any set-asides or special provisions.

In other words, it implied that really the problem with which the Federal Government tried to deal through its 8(a) program, Public Law 95-507, et cetera, did not exist sufficiently in the State of Hawaii to warrant any such programs at the State level.

That concerns me because I begin to wonder whether or not the money being spent here, some $10.5 million, I understand, last year in the Federal contract set-asides, is really warranted.

I ask that in light of the last page of your statement where you say—and Mr. Keith is here, and while you were out of the room I made reference to you, if you don't mind, and your responses to my questions regarding minority disadvantaged businesses.

I am about to quote just one sentence or two from the statement of Mike Kido who is president of the Construction Industry Legislative Organization, with reference to the same problem. I am going to ask Mr. Kido to respond.

It might be of interest to you. The quote is from Mr. Kido. It says:

> It is to the advantage of the Federal Government to extend increased opportunities to the minority business within the State of Hawaii to participate in Federal contracts. Efforts must be undertaken to reverse the decline of bid awards that have overlooked legislation and mandates that are designed to assist small business.

Now, Mr. Kido, I gather, is saying that there is a need for us to improve our efforts to provide equal opportunities to minority businesses in the State of Hawaii from your tax dollars, whereas I understood Mr. Keith indicated that the State of Hawaii has done such a job of letting of State contracts that the State has seen no need to have special provisions set up for them in contracting.

There seems to be a conflict there because I don't want to see tax dollars given to those who don't need it. I know other States where the dollars could be used very well.

Mr. **Kido**. Let me comment this way, Mr. Savage, and we certainly have a need here. As our third topic area which you cited from, we feel that it would be to the advantage of the Federal Government to increase that participation and perhaps since both Mr. Luiz and Mr. Belmont do quite a bit of Federal work, I would ask Mr. Belmont to comment since he screens most of the Federal bids let in the State and has some extensive experience in that area.

Mr. **Belmont**. Mr. Savage, to answer your question, I don't mean to defend Mr. Keith or the State of Hawaii. Our comments with respect to the discrimination or the lack of equal opportunity that we seem to see on Federal bid projects has been that of a strong diminishment in the last 2 or 3 years. Speaking of my own personal experiences, there are very few small business set aside type contracts coming from the Federal Government as opposed to that period of 3 years ago.

There are virtually no small economic disadvantaged business set asides, zero women-owned business set asides, and very few socially or culturally disadvantaged set asides.

Speaking from my experience, I review virtually every request quotation coming from the Navy and again as 3 or 4 years ago, virtually half or more in terms of numbers of bid requests had one or more of those types of set asides, whereas today there isn't 5 percent of the same type of bid requests coming out with the preference regardless of the nature of the minority.

The State of Hawaii, I believe if I interpreted Mr. Keith's comments as I sat in the audience earlier, I think his comments were that the State practices no discrimination of any sort and from an economic standpoint have not turned anyone down.

Our comments today were not addressed to the State of Hawaii, although they have been previously and in the future will be addressed to the State of Hawaii along the same lines as our testimony here is.

We are asking both the State of Hawaii and the Federal Government to please recognize that our population is essentially minorities, because some 95 percent of our business is, in fact, minority in some way, shape, form, size, ethnic background, cultural disadvantage, or whatever.

We are asking the Federal Government to recognize that and provide more opportunities for set asides or preferences for these disadvantaged firms as we are asking the State of Hawaii to do the same.

Mr. SAVAGE. Mr. Chairman, may I have a little more time to pursue this?

Mr. MITCHELL. Sure. Could you yield to me just for a moment? I want to have my own thinking straight. We are dealing really with reference to Mr. Keith's testimony. We are dealing with two different sets of problems it seems to me.

Mr. KIDO. I believe so, yes.

Mr. MITCHELL. Mr. Keith is talking about loans made through the State to small businesses. As I understood him, he is saying that there is no problem in terms of anyone being discriminated against in getting a loan.

I am trying to get my thoughts straight. It seems to me that is what he is saying and that is one category of possible problem or discussion areas.

The other area is in procurement and contracting with both Federal and State. Here we are running into, based on what I hear from you gentlemen, rather severe problems with reference to minorities.

It gets tied in since possibly that few get a contract, a Federal contract or State contract. You may need some kind of loan from the State to help you get through their contract.

That is where Mr. Keith's comes in. But am I right in assuming these are two discrete problem areas?

Mr. KIDO. I believe so, Mr. Chairman.

Mr. MITCHELL. Thank you.

Mr. SAVAGE. OK. Well, let me see if I can get this together, Mr. Belmont. I appreciate your consideration.

In the statement from your organization, when you refer to increased opportunities for minority business, are we talking about the same thing? I recognize that Hawaii is made up of minorities and may I say beautifully made up even from the short time I have been here.

Are you referring here to economically disadvantaged minorities as defined in Public Law 95-507?

Mr. BELMONT. Partially.

Mr. SAVAGE. All right. What I am getting at is in the earlier statement by Mr. Waidzunas of SBA, he says the 8(a) program was started in Hawaii in 1975. In the first year of operation there were 24 contracts for a total volume of $903,000, an average of $37,500 a contract. Then he says that at the end of fiscal year 1983, that as contrasted to the 24 contracts 8 years earlier, there were now 109 contracts under the 8(a) program and a total volume of $10.5 million as opposed to the 903,000, more than a 15-times increase.

The average contract is $96,000, almost a three-times increase over the 37,600, and as contrasted to 18 firms approved for 8(a) eligibility in 1975, that in 1983 you had 30 such firms.

Now, that indicates a substantial increase in benefits to disadvantaged minority businesses under the 8(a) program. If that increase is not warranted, and I am trying to find out whether it is, the only way I can see it is warranted if we can provide for these needs while we also protect the taxpayers' dollars.

Mind you, these programs cut into the open bid market, so there has to be a reason to justify for that increase. The only thing I can understand for that being justified is the existence in the State of Hawaii of economically disadvantaged minority-owned businesses.

These are businesses that are such because of prior discrimination in our Nation—not necessarily this island, you know, this State—but now either that is true or it is not. Are there minority-owned businesses in the State of Hawaii who because of the identification of its ownership deserves special consideration from the Federal Government in contracting?

Yes or no.

Mr. **Belmont**. Very definitely, yes.

Mr. **Savage**. If there are and they deserve special consideration from the Federal Government, why not from the State of Hawaii?

Mr. **Belmont**. They do deserve that same consideration and are, in fact, requesting it currently.

Mr. **Savage**. That is my problem with Mr. Keith's statement as he saw no need because such needs were included in the overall apportionment to small businesses.

Let me make this a little clearer. It seems to me it is on conflict. The reason we discriminate against nonminority, nondisadvantaged businesses by setting aside a portion of the business, that is a sort of discrimination, too, but the reason we do it is we have found that we must do that in order to overcome and correct past discrimination.

That may seem funny, but that is what you are doing, you know. Well, we do it and certainly in the concept of the present precedent of the New Federalism, that we try to do it in concert with and to supplement the State activities. This administration doesn't want the Federal Government to assume all the responsibility. It wants to be more of a model.

It is just a concept. Well, how can we have one interpretation and the State of Hawaii another about its own minority-owned businesses?

How can we justify a 15-times increase in the State of Hawaii's program when the representative from the State says they have no need for it?

Mr. **Belmont**. Perhaps we were listening to a different witness. I didn't understand Mr. Keith to make that statement. I think his comments were directed toward Hawaii economic development in terms of loan programs.

Mr. **Savage**. Excuse me, but I asked very specifically. I commented specifically, the record will show, regarding his statement on the loan program. I commended him for that.

Then I asked about the procurement process, contracting is the word I used.

I gave the example that the chairman had given regarding having economic development conferences involving small businesses and no one ending up with dollars they could directly attribute to participation in that conference.

I asked what kind of provision do you have in your contracting procedures to provide for economically disadvantaged minority businesses such as are described in the statement of Mr. Waidzunas, I don't see how that could have been misunderstood.

Mr. KIDO. Maybe I could comment on this, Mr. Savage. We, as an organization, have as a common practice taken opportunities of dialog with various policymakers, both in the administration, as well as elected officials. It is coincidental we are on Mr. Keith's itinerary this week and I am sure we will have an opportunity to have a dialog with him on this subject as well.

Mr. MITCHELL. Could somebody get us any portion of State law that deals with in any fashion treatment of set asides for or preference toward small or disadvantaged businesses under the law?

I think Mr. Keith indicated maybe there was such, either administrative law or some law that he was not familiar with. I think that is where we need to start to try to find out what is on the books at this time.

Does anyone know?

Is there any such provision in law? If you could get that for us.

Mr. KIDO. Yes.

Mr. MITCHELL. That is a starting point.

Mr. HAYES. Could I comment, Mr. Chairman?

Mr. MITCHELL. Sure.

Mr. HAYES. If I could get to a question that has been raised. It seems apparent that you as small business people suffered from the financial short falls all the time because of your inability, as you say, to get prompt collections, particularly in the area of the military. Is there any help that the Governor's Office can give in this direction of stimulating collections? That is one question. I gather from what you say you don't have a problem of promptness on the part of contracts themselves in filing the necessary papers in order to collect money due? Is that a problem? Could that be something that is on the part of the contractors?

Mr. BELMONT. With the economy in the last 2 years, everybody has experienced delay in payment. My own company certainly has experienced a slow-down in payments from all customers, but not to the extent of the slow-down we have had from the Federal Government. That has lengthened or extended dramatically beyond that of normal commercial obligations from contractors as an example.

Mr. HAYES. Do you bill directly to the Defense Department if it has to do with the military?

Mr. BELMONT. Yes, we do.

Mr. HAYES. Thank you, Mr. Chairman.

Mr. MITCHELL. Let me assure you there will be an immediate followup on this. It seems to me this has broken out into several action areas. One, I think it is mandatory on the part of the committee to communicate with the Department of Defense and the Secretary of the Navy and all the agencies of Government on this problem.

We simply have to urge them to not hurt small businesses by this kind of foolishness of a 45-day delay period before acting and all that. We will follow through on that.

Second, when the second session of the 98th Congress begins, we will have an oversight hearing on the Prompt Payment Act, the purpose of which will be to amend that act to make it stronger to try to avoid this particular problem.

Mr. Kido, you have two or three other areas you wanted to get to.

Mr. KIDO. Yes, Mr. Chairman.

Mr. MITCHELL. We really got into them, haven't we?

Mr. KIDO. Yes, I think we have gone into minority set asides, the second area.

We would ask whether you wish us to continue to proceed within the time limit or if we can submit our written comments as we have.

Mr. MITCHELL. Proceed just as you have been doing up to this point and get to the third area I know you have an interest in.

Mr. KIDO. The third area, actually our second, dealt in the area of disadvantages of local contractors bidding on Federal contracts. It was a difficult area to articulate.

That is part of the reason for the shortness of the statement. Yet, I believe there are several panelists that have been experienced in bidding Federal contracts that could share them with you at this time.

Mr. LUIZ. In the area of contracting for military procedures, we, as local contractors have not seen a minority set-aside program other than the few, the 30 or so contracts that Congressman Savage talked about that go to firms below a certain amount of dollars.

When you reach that level of just that amount there is nothing in the set-aside area for minority contractors up to the small business limitations, whatever, 12 million or something like that. So if you get over a $¼ million and you get to a job of 400 or 500, there is no advantage or no vehicle that you can use for minority contracts. Then we get contracts from State-side that filter through and the Government says they don't invite them but these guys say they have information on meetings and everything on the coast that they bid on our marketing here.

These are generally not minority contracts. When they bid a job here they come in and get free or at very little cost storage on the base, warehousing, office facilities, then they bid work on the outside marketing which we call the private market.

They generally slip out of our 4 percent State tax, they pay a lower workmen's comp rate because they come from another State and we are one of the highest workmen's comp areas. We just cannot compete against them. That is about all for that.

Mr. Belmont has an area that is similar for supplies.

Mr. BELMONT. The contractors that Mr. Luiz was referring to would be the mainland contractor who bids the Federal Government job, and is the low bidder. Since he has no shop or overhead as such in the State of Hawaii, he moves to that Federal Government base where he is provided with warehousing, storage, and often air conditioned offices at no charge.

He is not a minority provider, nor is he a minority set-aside contractor, and he can quote material to the government from Stateside and not have any disadvantages that a local contractor has, that is: having to pay State sales tax or pay other inherent costs of overhead of doing business in the State.

Thereby the small business or minority business here, without having any set-asides, is given a double disadvantage in trying to compete with his mainland counterpart. It is a very unfair advantage the mainland counterpart has as both general contractor and material supplier.

As Mr. Luiz points out, many of the contractors from the mainland come to Hawaii, begin a job on the Federal Government project using that Government facility with a zero cost or very low cost as a basis for beginning to bid work in the private sector against the local supplier or local contractor with the Federal Government inadvertently or unwittingly absorbing that contractor's overhead.

That would not have happened if it was monitored closely by the contract administrator or if the contracts were made available to the socially disadvantaged or economically disadvantaged type firm.

Mr. MITCHELL. I think I follow you completely and I was searching in my mind whether there is any existing remedy under the law. I was looking at Public Law 95-507, but that wouldn't help you much because the prime comes with all the advantages and can sub with minorities and still fall within the provisions of Public Law 95-507, and those subs could be mainland subs. They don't have to be Hawaii subs.

Mr. BELMONT. Mr. Chairman, We have yet to get an answer from the Federal Government as to why a sub of any sort is provided free housing or free warehouse or storage, or utilities.

Mr. MITCHELL. Let me interrupt you. That does seem to me to be on its face demonstrable evidence of the kind of preferential treatment not envisioned under the law. If I were going to compete with you and I could warehouse my stuff free, I would kick you every time in competing for contracts. Let's look at it.

Tom, give particular attention to this.

Mr. POWERS. Yes, sir.

Mr. MITCHELL. Do any of you gentlemen know any law that provides for this? I assume this is an administrative law or practice set up within DOD. Let's take a good hard look at this one.

Mr. KIDO. Mr. Chairman, in closing, Mr. Miura, in his 21 or 22 years, wants to cite an example in this area.

Mr. HAYES. Could I raise one question first related to this whole matter?

Mr. MITCHELL. Sure.

Mr. HAYES. You raise the question of the workmen's comp, the rate being lower for those out of State.

Mr. LUIZ. We have a gross income tax we pay on total billing. Generally a firm from the coast can slip in, do a job and slip out without anybody picking him up on the 4 percent. Generally that contractor moves all around the country and does work all over in many States. It is very hard to keep track of them.

Mr. KIDO. Excuse me, was your question on workmen's comp or taxation?

Mr. HAYES. Workmen's comp particularly, I know it varies by State in terms of amount of tax paid. I wonder how someone from the States can come in and pay less than you do here?

Mr. LUIZ. He doesn't pay it.

Mr. HAYES. Oh.

Mr. Mitchell. I want to hear from you, too, but you raise another interesting point for me. You say these guys slip in.

Mr. Luiz. They come in and out.

Mr. Mitchell. If they came in and were in a bona fide manner here, they would be required to pay the 4 percent?

Mr. Luiz. If they came in to the State and registered with the State contracting and licensing division, the State would know when they are in or out. The State now has to depend on the Government agency sending a message every time a new contractor gets a job in Honolulu. Being the way everybody is on a cutback, that information doesn't flow readily. So they catch a few, but most of them slip out.

Mr. Mitchell. It gets there late. After it gets there late and the State is aware of it, can the State then bill?

Mr. Luiz. The State tries their best to chase the guy, and he might return to Honolulu 2 years later under a different firm.

Mr. Mitchell. And right out again?

Mr. Luiz. Right. I am sure the Government facilities can see it. They have people coming in here three or four times under three or four different company names.

On workmen's comp, we have one of the highest rates here. I have people on my payroll that I pay $2.80 or $3 per $100 payroll, and some of these firms come in and pay one-third of that or less.

Mr. Mitchell. That is based on what it is in their State where they are home based?

Mr. Luiz. That is right.

Mr. Kido. Yes.

Mr. Luiz. We have other firms that pay $5 on a $100 payroll depending on the trade or field you are in.

Mr. Mitchell. I would like to pursue this, but we really haven't heard from you. Could we hear from you and come back to any further questions in this area?

Mr. Kido. Thank you.

TESTIMONY OF WALLY MIURA, PRESIDENT, WALLY'S FLOORING, INC., ACCOMPANIED BY ALLEN L'ESPANOS, RESOURCE PERSON, GENERAL CONTRACTS ASSOCIATION OF HAWAII

Mr. Miura. Mr. Chairman, I am Wally Miura. I am a small flooring contractor. We supply the Government, and we do installation and contract work with the Government. One of the disadvantages that we face here in Hawaii is that we are 2,500 miles away from the mainland. When we put in our orders for materials, a lot of times it takes a month to get here. In the meantime, we cannot process for payment unless our materials are at the jobsite.

A lot of times there is no jobsite storage facilities for us. Therefore, we have to store it in our warehouse, which we have been paying 75 cents a square foot, and it makes it hard for us. We cannot get paid, we are storing the material, a lot of times the job is not on schedule where the contractors might have problems with delays.

In the meantime, we are stuck here with all the material to be paid, cash flow becomes severe because we have to pay the suppliers or have our credit marred, and it is really hard for us. If we are to get paid finally, we would have to put it into a bonded warehouse and small business people can't go through all these costs. We find it very disadvantageous to us because I know for a fact that there was some Government jobs that people from the mainland came in, they had room where they just put up a shack and had all the materials delivered there and probably collected money and no storage fee or virtually none, and when the job is ready, they send a man, finish the job and move out of town.

We are locally here trying to support our workers, and this is a problem, and has been, and I am sure it has been with all the rest of the contractors, like myself.

[Mr. Kido's prepared statement follows:]

PREPARED STATEMENT OF C. MIKE KIDO, PRESIDENT, CONSTRUCTION INDUSTRY LEGISLATIVE ORGANIZATION, INC.

On behalf of the Officers and members of the Construction Industry Legislative Organization, Inc., we wish to thank you for this opportunity to testify before your Committee in Hawaii.

In order to facilitate your proceedings and promote dialogue in the three topic areas, we wish to comment on, may we respectively submit our written testimony into the records.

The three topic areas that we wish to comment on are: (1) Prompt payment on the part of the Federal Government; (2) Inherent Disadvantages of local contractors bidding on Federal work; and (3) Minority Set-aside program—Hawaii Construction Industry Perspective.

Despite the passage of the "Prompt Payment Act", the Federal Government has, in fact, made little, if any improvement in the payment performance of its commercial trade obligations. Slow payment habits are encountered with all sectors of the Federal Government but particularly so with the military. The Navy and its various procurement activities are typically the most delinquent of all the military.

Internal audits by member firms have revealed that the Naval procurement section, for example, pays commercial invoices on an average of 74 days after receipt of materials, while the Federal Government Contracting Section averages around 45 days. The delinquent remittances are an economic burden on small business and contribute to an already strained cash flow problem.

Failure on the part of the Federal Government to take advantage of cash discounts for prompt payment merely increases Government procurement costs. Payment of interest by the Government for delinquent balances not only add to the deficit but do not adequately reimburse the creditor for the actual expenses incurred in financing the Government accounts payable balances.

The vast majority of slow payments, lost cash discounts, and interest by the government can be traced directly to inefficient and in adequate staff within the Government's accounting offices. The combined effect of these lost discounts and interest paid, amounts to many millions of dollars and more annually on a national basis within the military alone. The figures would be staggering if totalled for all governmental spending.

As will be articulated by this morning's panelists, local contractors have found themselves at a distinct disadvantage in competitively bidding Federal contract work in the past few years. During these economic times, any job cost bidding advantage is inherently a major disadvantage for any licensed bidder of Federal contract work. Any "free" storage, office space and other job related cost which are fixed for local contractors can serve as a further advantage for a bidder utilizing these "free" services while bidding on other contracts while operating from his initial work project that brought that bidder into the State.

Hawaii is unique in that it is the nation's only island state. It is also unique in many social, cultural, and economic ways owing to the state's geographical proximity to the U.S. Mainland.

The capital of Hawaii, Honolulu, is located on the island of Oahu, a Hawaiian word meaning "gathering place". Hawaii has truly become the "gathering place" for peoples of many different national origins. The state's million-plus population, still today, consists primarily of Japanese, Chinese, Filipinos, Portuguese, Samoan, Polynesian, and many other ethnic minorities all blended into the "Aloha State's" unique business and cultural environment.

Hawaii's economic base is substantially dependent upon tourism, agriculture, construction, and military spending. Of these four economic segments, military and related Federal spending within the state has declined in recent years as a direct result of a greater portion of these expenditures which have been rewarded to out-of-state bidders.

There has been a dramatic decline in Federal Government bid requests under "Small Business" set-asides or preference to the "minority owned" or "Woman owned" or other "socially" or "economically disadvantaged" business. The vast majority of private enterprises in Hawaii readily qualifies under Government definition as one of these "Small" or "Disadvantaged" types of firms and actions by the Federal Government in recent years has served to minimize these firms opportunities to participate in governmental contracts.

It is to the advantage of the Federal Government to extend increased opportunities to the "Minority" business within the State of Hawaii to participate in Federal contracts. Efforts must be undertaken to reverse the decline of bid awards that have overlooked legislation and mandates that are designed to assist small business.

Loss of jobs, reduction in tax collections, increased Federal assistance requests are but a few of the negative impacts that may be avoided if the Federal Government will review and amend it's bid and award practices within Hawaii. Small business within this State does not seek unfair advantage in dealing with the Federal Government, rather, we merely request fair and equal opportunity under provisions that are apparently being inadvertently overlooked.

Mr. MITCHELL. Thank you. I am treading my way through, all of us are, because this is a unique problem for your State. I can see some things we can do. I really don't see what role the Federal Government could play in terms of warehousing your material except where it is done free on a military installation, we have a job to do there. But I really question what role the Federal Government could play with this other problem. I just don't see how we can help on that. Do you?

Let me just say that storing property, delays in delivering equipment and materials to you, all the things that might mitigate against successful completion of your contract on time, is a whole category of problems that I don't see a Federal role in. Maybe I am missing something.

Mr. MIURA. Mr. Chairman, I am sure all of us here are asking for just a fair chance. If we are to rent a warehouse and continue our business and we have to pay storage and it is one of our overhead costs, we ask that the other competitors likewise would have to be equal to everybody coming in and competing; if they are coming in, they should send their materials over to a warehouse and figure on storage, transportation, what not.

I feel that we will have a more equal open bid type of nondiscrimination situation.

Mr. MITCHELL. I hope we can help on that part of it, of providing free facilities which is flying in the face of the free enterprise system, of course.

I think we can help on that. Some of the other areas, no.

Mr. SAVAGE. Mr. Chairman, may I ask a question.

Out of curiosity, because I certainly feel the chairman knows we should not have free storage and so on in Government facilities, but where a Hawaiian-based contractor has a contract in another State, say in California which has a large defense industry, do you feel the same advantage over contractors on the mainland?

Mr. LUIZ. Mr. Savage, with my 25 years or so trying to struggle and make a business run, I have not heard of a contractor in the small business type area, $12 million annual sales and below, doing work on the coast, on the mainland. So I don't know what experience we could call upon in that area. I can't recall anybody doing any work on the west coast or any other place on the mainland.

Mr. **Mitchell**. Thank you.

Mr. **Savage**. What I was trying to bring to our attention was where a mainland-based corporation comes to do business in Hawaii and uses certain Government facilities to the disadvantage of the local businesses, we may want to check through the Small Business Committee staff to ascertain that the same advantage accrues to the Hawaiian businesses when they do business in another State.

Mr. **Mitchell**. We may be enlightened on that more. Mr. Lyons is a witness later on. He will testify about a law enacted by the State that requires a firm to be licensed by the State in order to bid on contracts in Hawaii. That is the general picture I have. So maybe we can be enlightened more when we hear from him. Are there other comments?

Mr. **Belmont**. Mr. Chairman, one final comment or question, if I can combine them. We again have asked on numerous occasions for a Federal Government interpretation or evaluation of the set-aside or preference type of bid which we have seen a dramatic decrease in, is that national? Is it regional? Is it Hawaii only? Is there a given portion of the Defense budget or contracting in general being set aside each year?

If so, how is it administered? Why has there been a dramatic decline in this State that we have been told has not happened on a national basis.

Mr. **Mitchell**. I regret to say it has happened on a nationwide basis. That is why early on when I made a statement to the effect there has been a general retreat on the part of the Federal Government to its commitments that it made to minority businesses and to small businesses, and certainly this committee on which I serve and have the honor of chairing is a very bipartisan committee, but I would be less than truthful if I did not say that under the present administration there is a perception on the part of the agencies of Government that, one, they do not have to live up to compliance with the law; and, two, that no one is going to prod them very hard in terms of helping minority businesses.

I think the whole scenario that has been laid out for us is retreat on affirmative action, the whole question of the civil rights struggle that went on in the Congress between the Congress and the administration, all of these are symptomatic of a new kind of climate. And all we can do is to bang at it in oversight hearings, which we mean to intensify next year, to be sure that existing law is complied with.

But honestly it is not just Hawaii. I can tell you by way of illustration that the general figures under the Small Business Administration in terms of direct loans and EOL loans, since this administration has taken over, those two types of loans have dropped by 50 percent and it is clear that someone thinks that that kind of operation is philosophically in sync with the philosophy that the present administration has associated itself with.

We will keep banging at it. It irritates me really when I see some of the bureaucrats act with sheer arrogance, saying that may be the law, but we don't have a go-ahead signal. You darned well don't need a go-ahead signal to comply with the law.

Just as an aside, I might say that I have sued agencies before and when everything else fails, I will sue them again. We initiated a suit against GSA for not complying with Public Law 95-507 and before it got to court, they pulled all their contracts back and brought them into compliance with the law. But we shouldn't have to do that. We have established a minority business legal and education fund simply because we assumed that we had to have our own attorneys and that fund is going to be used not for individual cases but for class actions where there is agency noncompliance with the law.

I hate to lay it out that starkly to you, but that is the reality of today's conditions.

Mr. SAVAGE. Mr. Chairman, may I ask, to be sure I follow you, gentlemen, I gather when you talk about the diminishing amount of Federal consideration for any minority-owned businesses that you may have reference to direct loans or loan guarantees, but in the State of Hawaii, are you suggesting that the contract set-aside program, for instance, is diminishing in its effect?

Mr. MITCHELL. Yes.

Mr. BELMONT. On the basis of the Federal Government's request for public bids within the State of Hawaii, dramatically so.

Mr. SAVAGE. You see, what concerns me then is that we have a statement earlier this morning from our local SBA Director who claimed the opposite and gave us some numbers. Were you present?

Mr. LUIZ. Weren't they talking about loan applications?

Mr. SAVAGE. No; he did not refer to loan portfolio or applications at all. I am talking about Federal Government procurement.

The SBA Director was here this morning and claimed that in Mr. Waidzunas' testimony, I believe.

Mr. MITCHELL. What I had reference to was in the testimony of the District Director, where he said "Under the prime contracting program total small business awards in Hawaii have increased from 44 percent in 1981 to 63.5 percent in 1983."

Mr. SAVAGE. That is my problem, Mr. Chairman.

That is backed by Mr. Waidzunas' statement that the total volume of contracts for minority businesses through the SBA Program increased from $900,000 to $10.5 million.

Mr. MITCHELL. Yes.

Mr. LUIZ. Mr. Savage, let me try to get you straight on that, or get myself straight on it. I think what they are talking about is the area of when SBA goes out and helps a minority contractor or small business firm, go out and do the negotiating with the Government and obtain a contract direct from the Government. That is what you are talking about.

Mr. SAVAGE. Yes.

Mr. LUIZ. OK, that has a limit of dollars and I am not familiar with the limit, but I know my firm doesn't qualify for that.

Mr. SAVAGE. Not a limit, a goal. Call it a goal.

Mr. LUIZ. They won't even talk to us if we gross over so many dollars worth of business, so you have to gross below that, a couple of hundred thousands.

Mr. Savage. I see.

Mr. Luiz. They won't talk to us, or Mr. Belmont or anybody here at the table. We are sitting in between, or just above that area, or even a million dollars above it.

I guess what we are looking for is some consideration from the Government in a bid list they put out maybe or in a request for minority contractors to bid on this work and be able to bid up to maybe a small business ceiling of $12 million. There is no category in there that we have any advantage in. If you gross $200,000 or plus, you are out.

Mr. Mitchell. I understand.

Anything further? I don't want to cut you off, but we have a large number of witnesses. We will take additional comments.

Mr. Kido. Just to say thank you on behalf of the panelists. If you have further questions, we would be happy to answer them.

Mr. Mitchell. It is quite the other way around, we should thank you. It is obvious we have gotten into real problem areas that I think the Federal Government has the responsibility to resolve. This is precisely the kind of testimony that we wanted to hear. Thank you, gentlemen.

Our next two witnesses will be Robert Robinson, president, Chamber of Commerce of Hawaii; and Ms. Bette Tatum, chairwoman of the Governor's Small Business Advisory Council. I believe Ms. Tatum has someone with her. We will take a quick 10-minute break after this panel if that is all right.

[A short recess was taken.]

TESTIMONY OF ROBERT B. ROBINSON, PRESIDENT, CHAMBER OF COMMERCE OF HAWAII

Mr. Robinson. Thank you very much, Mr. Chairman.

I have a panel of five people besides myself.

Mr. Mitchell. We will call on the five others later on during the course of the hearing.

Mr. Robinson. Thank you.

The Chamber of Commerce is an organization of some 2,500 firms, and we have about 3,900 members aside from some associate chambers in the State with another 3,000 members and all but a handful of them are small business.

Most of the testimony we will give deals directly with small business problems, but I wanted to talk to you about an overall State problem because it is so important to the entire State, that is the sugar problem for Hawaii. While it is generally associated with big business, because sugar is an export and because there are so many small businesses dependent on it, it is a problem for the whole State. We have for every sugar employee about 2.25 other employees, most of them small business, so it is a serious problem.

Now, Hawaii produces about a million tons of sugar. If you will turn to my text, you will see that about 18 percent of all the sugar produced in the United States is produced in Hawaii. Our cost is about 20 cents a pound.

Unfortunately, the world sugar price is now at about 9 cents a pound and if it weren't for the fact that we are protected at the moment by the Agricultural Act, as we got protected last year, I think we would go out of business in sugar.

For 40 years we were protected by a Sugar Act and that went out in 1974. Since that time, the price of sugar has skyrocketed first and then has gone way down and then way up and way down, and I have figures in this testimony which will tell you where it is, but essentially it has been on a roller coaster up and down.

The reason for that is that we are the only industrialized nation that doesn't control or hasn't controlled the sugar price in some fashion. Every other industrialized nation does have some control on sugar price. Usually it is a quota system.

Of course, we are under a quota system now. I said we produce about one million tons of sugar. Well, there is about 100 million tons in the world produced, so we are about 1 percent of the world production. The United States consumes around 10 percent of the world production or 10 million tons, and we produce about half that, about 5 million tons, and we produce in Hawaii about 18 percent of that total amount.

So, with the United States consuming 10 percent of the world consumption, only about 15 percent of that consumption is on the world market, the rest is all controlled. So we in Hawaii are very dependent on this world market price. You see that two-thirds of the consumption of free market sugar is consumed by the United States, 10 of the 15 million tons on the free market. So because of this roller coaster situation, it makes it very difficult for growers all over the United States.

We, of course, are one of those big growers. Totally I think there are 18 States that produce sugar in the United States.

So what I have said in my testimony essentially is that if the United States intends to stay in the sugar business, the country needs a long-term sugar policy. We need truly something like the Sugar Act, but we certainly need some long-range assurance that at least we will be included in the Farm Act. Otherwise it would not behoove people to continue their investment in sugar.

Sugar is essentially our biggest agricultural crop. We have 220,000 acres in sugar, and we think only about 5,000 of that could be utilized for any crop if we should go out of sugar. This is from a longstanding study that has been made in this area. If we should go out of sugar what would happen unemploymentwise is fantastic. Especially on Kauai, we estimated that the unemployment rate would be 20 percent there if we didn't have sugar. We have said that on the big island it would be 16 percent and on Maui, it would be 14 percent and totally the State tax revenue would be going down by 10 percent without sugar. So it is a substantial concern to the whole State. I think it is the Achilles' heel, if we have one, in our total State economy.

Two facts that I brought out in my testimony, if you would be kind enough to review it, is that every country in the world which can grow sugar does grow sugar. It is interesting to note that the biggest grower is Russia, of all things. You wouldn't think of them as being a sugar producer, but they are.

Second, every industrialized nation protects its sugar in some way, and we do it, just barely protect it, by putting it in the farm bill this last time. It only made that by one vote, I think, in the

House. What Hawaii needs probably more than anything else from Congress is a firm commitment that Congress wants the United States to remain in sugar production and that it will protect this industry in some kind of a long-term basis.

[Mr. Robinson's prepared statement follows:]

PREPARED STATEMENT OF ROBERT B. ROBINSON, PRESIDENT, CHAMBER OF COMMERCE OF HAWAII

I am Robert B. Robinson, president of the Chamber of Commerce of Hawaii. I am speaking on behalf of more than 3,900 individuals representing 2,500 firms, and another 3,000 members from associated ethnic, neighbor island and local community chambers of commerce in our state.

Sugar and Hawaii.

I would like to talk to you for a few minutes about sugar and Hawaii.

Since World War II, the foundation of Hawaii's economy has been its 2 prime "invisible" exports: sales to the federal government, primarily the defense agencies, and sales to overseas persons who come as tourists; and its two prime "visible" or commodity exports - sugar and pineapple. The fate of one of these exports, sugar, is essentially in the hands of Congress.

While Hawaiian sugar is associated with big business, because it is an export and because there are so many small businesses dependent on sugar, the fate of sugar is important to all of us. For every sugar job, there are 2.28 non-sugar jobs indirectly created by the sugar industry.

The Chamber of Commerce of Hawaii

Hawaii produce annually one-million tons of sugar, about 18% of all sugar produced in the United States, and we are among the world's most efficient producers. We lead the world in sugar research and we are highly mechanized. Our costs are about 20¢ per pound.

Unfortunately, however, due to record low world prices, currently about 9¢ per pound, Hawaii along with the rest of the nation may be driven out of sugar production. Our country currently produces about half its sugar. The rest comes from surplus sugar produced largely from countries who in one form or another subsidize their crops. The United States is the only industrialized nation who buys sugar on the free market.

Of the roughly 100 million tons of sugar consumed in the world annually, only about 15 million tons are on the free market, so a small change in world production has a tremendous impact on price. That impact in the last few years has caused wildly fluctuating prices. And the U.S. which consumes two-thirds of the free market sugar has been the victim of this leveraged fluctuation.

Using Hawaii as an illustration, in 1974 sugar income amounted to $665 million, dropping to $227 million in 1977, rebounding to $594 million in 1980.

This year, because sugar is now included in the farm act and has the price stability afforded by a quota system, sugar will be approximately break even.

But who will invest in a break-even industry, or for that matter, continue in that industry for very long without the assurance of a reasonable return on investment. This can come only from a long-term commitment from Congress that it wants the eighteen states that currently produce sugar to remain sugar producers.

Hawaii Without Sugar.

With sugar representing approximately 8% of the total civilian employment and 8% of total income in Hawaii, the demise of the industry would wreck havoc on Hawaii's economy. If nothing else occurred, unemployment would double, tax revenues would decline by 10%. There would be no way under these circumstances for government to cope with the welfare burden or maintain essential services. It has been estimated that if even half those supported by the sugar industry were forced to go on welfare, the cost would amount to 17% of the State budget.

On our neighbor islands, the results would be disasterous.

Over 96% of Kauai's crop land is in sugar. Without sugar unemployment on that island would raise to 20%. Similarly, with over 82% of the island of Hawaii's crop land in sugar, unemployment would raise to 16%. With 47,000 acres in sugar, Maui's unemployment would be 14%.

Through the years, many efforts have been made to find substitute crops for Hawaii's sugar land but with little success.

Estimates have been made that only 5,000 acres could be utilized. The rest of the approximately 220,000 acres in sugar would, for the most part, lie fallow. This has been the experience of those plantations which in recent years have gone out of business.

Two facts are interesting:

1. Every country in the world which can grow sugar does grow sugar.
2. Every industrialized nation protects its sugar pricing in some way.

What Hawaii needs most from Congress is a firm commitment that it wants the U.S. to remain a sugar producer and that it will protect this industry on a long-term basis.

Mr. MITCHELL. Thank you.

I have been through this several times in my tenure in Congress. First of all, you are given some protection under the Farm Act.

Mr. ROBINSON. Yes, sir; in the farm bill.

Mr. MITCHELL. That is until 1985.

Mr. ROBINSON. That is right, it is a 4-year act.

Mr. MITCHELL. So you have a couple more years with some kind of protection.

Mr. ROBINSON. That is right.

Mr. MITCHELL. Let me tell you what fascinated me most about your testimony. Unless I am way, way off base, sugar is big business.

Mr. ROBINSON. Sugar is. It is big business in the country at large.

Mr. MITCHELL. Of course, it has an impact on small business, but it is big business. There is no question about that.

Mr. ROBINSON. It is big business in Hawaii, yes, it is.

Mr. MITCHELL. Then it seems to me that what you are requesting almost flies in the face of what the big businesses are demanding from the administration—little or no Government intervention; let the free market operate without any interference; let prices be established in the free market; don't subsidize in any fashion small or minority businesses; and, certainly the large businesses don't want assistance.

It almost seems to me that you are asking us to take actions that are in almost contradistinction to what we are assuming the corporate world has told the President and what the President has told the Congress.

Mr. ROBINSON. Mr. Chairman, you are absolutely correct, but you have to recognize—and in most commodities we would believe that—in the case of sugar, every industrialized nation controls the price of sugar. Let me give you an example.

Mr. MITCHELL. Could I interrupt you just 1 more second.

Mr. ROBINSON. Sure.

Mr. MITCHELL. So, OK, now the big dairy farmers say: "Well, look, we need some help. The Federal Government ought to do this, this and this, but we don't want that kind of Federal intervention in any other areas, but we want it for dairy."

Now you want it for sugar. It is almost as if it is a question of whose ox is being gored.

Mr. ROBINSON. Of course, that is the most apparent question you would ask. But let's take, see where the sugar is coming from, that 50 percent that comes from outside the United States. A lot of it is coming from the common market nations of Europe. They are producing sugar at around 26 cents a pound, and they sell it in the European community at 28 cents a pound.

We produce substantially cheaper at 20 cents a pound, but they are dumping their excess sugar. It is the dumping that is the problem. They are dumping their excess sugar on the American market because the total free market amount of sugar is only 15 million tons, and we consume 10 million of that. When there is a surplus, the American market gets dumped on from whatever source. But it is the surplus protected and subsidized sugar that is being dumped on the American market; that is our problem. If it weren't for the problem of subsidized and dumped sugar, we would not be asking for protection.

Mr. MITCHELL. I hear you. I think you have made your problem very, very clear. By the way, there is very little this committee can do about that problem.

Mr. ROBINSON. I appreciate that.

Mr. MITCHELL. Except we will see to it that a copy of your testimony is given to the Agriculture Committee.

Mr. ROBINSON. I appreciate that very much, and the rest of our testimony of other members will be strictly on small business issues, but this is of such great concern to the entire State that whenever we in the State get an opportunity to talk to somebody in Congress, we like that opportunity.

Mr. MITCHELL. I don't blame you one bit for doing that, and I hope you don't fault me for my almost playing the devil's advocate role here.

Mr. ROBINSON. No; it is an obvious question, and——

Mr. MITCHELL. We get banged on, get government out of the private sector. You are supporting these minority businesses but if they were worth anything, they would be out there competing by themselves.

It is just sort of paradoxical—that is not the word, but it is certainly a shock to have somebody come in and say, "But this part of the private sector is special."

Mr. ROBINSON. Well, it is in Hawaii and, as I say, less than 100 of my members are big business, probably 50 out of 2,500. So, our heart is certainly with small business, but a lot of these people are supplying sugar.

Mr. AKAKA. Mr. Chairman.

Mr. MITCHELL. Yes.

Mr. AKAKA. Thank you very much for this opportunity.

Bob, I fully understand what you are talking about. Like you say, there is no question where the Hawaii delegation is concerned. We will be looking at 1985 when it comes up again with the Food and

Agricultural Act of 1981. But I just want to mention that what you have pointed out here is that sugar does impact many of our small businesses in Hawaii.

We started with about 500 independent sugar growers in Hawaii and because of the decline in sugar production here because of the market, we are now down to about 200 independent sugar people. These are growers, or farmers. The other part that is maybe different about our sugar communities is that sugar really benefits and supports communities in Hawaii. All of our islands have communities supported almost entirely by sugar. Should sugar go out, these communities would die. Period.

This is important, the importance that sugar has for Hawaii. We know it is big business, but there are many small businesses that depend on it, and without sugar in our communities—I repeat—communities and small businesses would die. Sugar has been a big part of our island community for over 100 years, and we are struggling to keep it alive and in Congress our delegation would certainly carry forth this support of sugar with the other 17 States in our country.

Thank you.

Mr. MITCHELL. Congressman Savage.

Congressman Hayes.

Mr. HAYES. Just a question. It arises from curiosity more than anything else. Are there refineries here owned by local growers or mainland companies, and where is Hawaiian sugar refined?

The other is, you mentioned the cost per pound for sugar produced in Hawaii as compared to maybe whatever else somewhere else. Costa Rica I understand is one place where a lot of sugar comes from. What is the labor cost, say, of a pound of sugar here as compared to the States or somewhere else?

Mr. ROBINSON. The labor cost is not much different as a percentage of the total cost. But our labor input has gone down substantially. It has gone down from a maximum, I think, of around 45,000 workers down to—it is so mechanized now—between 8,000 and 9,000 workers. It is the most highly mechanized agricultural business in the world probably.

Mr. HAYES. Ownership. Some of the big refiners.

Mr. ROBINSON. Sugar is refined by a number of plantations locally who are owned by the five large companies, but they jointly own a refinery in California, C&H, that refines the final sugar. The raw sugar is refined here. There is a small refinery here for just local consumption of finished sugar, but raw sugar is transported, I think it is up to about 98 percent pure, and it is sent to California where it is refined at Crockett. It is in a refinery jointly owned by the industry.

Mr. HAYES. If there was increased governmental subsidies for sugar producers, would you see it at the refinery level or at the small farmer level?

Mr. ROBINSON. There are no subsidies as such. What it is is a quota system that controls the price. If you give a certain quota in a certain area, which is the way it goes now, the price can be controlled in that way, but there are no subsidies.

Mr. HAYES. You are not seeking any either?

Mr. ROBINSON. No.

Mr. HAYES. Thank you.

Mr. MITCHELL. I hope you didn't misinterpret my colloquy with you. I am not anti-American sugar, but I am struck by the——

Mr. ROBINSON. No, sir.

Mr. MITCHELL [continuing]. Lack of parallelism in this.

Mr. ROBINSON. That is certainly true. There are very few nations that could produce sugar for what it is selling on the world market now. I don't know if there are any.

Mr. MITCHELL. Thank you very much. We will hear from all your witnesses. By the way, before we leave we will hear from every person who is here to testify. We will take Ms. Tatum next and then that 10-minute break I have been trying to get to.

Thank you.

TESTIMONY OF BETTE TATUM, CHAIRMAN, GOVERNOR'S SMALL BUSINESS ADVISORY COMMITTEE, AND STATE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Ms. TATUM. Thank you, Chairman Mitchell, Congressmen Savage and Hayes, welcome to Hawaii. Congressman Akaka, welcome home.

My name is Bette Tatum, and I am chairman of the Governor's Small Business Advisory Committee and am State director for the National Federation of Independent Business.

Over 95 percent of our Hawaii businesses are small, so a healthy Hawaii economy depends greatly upon a healthy small business community. Acknowledging that fact, the State government and the small business community are making positive strides in Hawaii, especially during the past 2 years.

One month ago we held our third Annual Statewide Small Business Conference. As in the first 2 conferences, between 400 to 600 small business people from throughout the State attended, with many of them participating in our workshops and open forums. We are especially pleased that this year over half of our State legislators attended and many of them, too, participated. Also, many State department directors also participated. In a recent national survey, our conference was given a No. 1 rating.

Hawaii is the only State with a small business coalition, made up of all small business organizations, working together for more than one legislative session. We are now starting our third session with our goal continuing to be communication and awareness between Government and small business.

Governor Ariyoshi 1 year ago, appointed Hawaii's first Small Business Advisory Committee. A national survey of small business assistance in the States ranked our committee, along with Tennessee's, as No. 1 in the Nation in effectiveness. Mr. Keith mentioned the committee the Governor commissioned to delve into Hawaii's strengths and weaknesses as a business location. We were mandated to have a report to the Governor before the 1984 legislative session, and we did that. The report, along with recommendations, is on his desk.

Because of your apparent interest in our small business concerns by flying thousands of miles to visit us, I am attaching for your information Hawaii's 1983 Statewide Small Business Conference ballot results to give you an idea of our State level concerns.

As to the Federal level, we share the mainland small business concerns: Skyrocketing payroll taxes, need for reg flex expansion, reauthorization of equal access to justice, increased paperwork reduction, exempting small contractors from Davis-Bacon regs., expanding private sector contracting, allowing Federal purchasing offices to buy from local businesses when cost effective, and allowing small firms to borrow from their pension funds.

Then we are also interested in your bill and committee member Joseph Addabbo's bill, Chairman Mitchell, considered major small business legislation to retool the nuts and bolts of obtaining Government contracts. That bill, as well as your committee member Toby Roth's and Senator Alan Dixon's bill appears to be good news for small business. I congratulate you for recently finessing your bill past the Armed Services Committee. I thought that was very nice.

Also, on the subject of Government procurement, Hawaii's Senator Dan Inouye informed us recently that he is preparing a pamphlet for Hawaii's small business community about opportunities to sell goods and services to the Federal Government. Getting the news out to the businesses is a good first step.

To give you specific problems small concerns encounter in Hawaii regarding the Federal Government, I have brought with me today one NFIB member. I was going to have two members of the NFIB with me today, but one of them became ill. She is flat on her back. You don't very often get sick in Hawaii, but anyway I have brought with me Joe Donaghy, who traveled from Maui today for the purpose of appearing today. I want to introduce him at this time and ask him to make his statement for the committee.

[Ms. Tatum's prepared statement with attachments follows:]

PREPARED STATEMENT OF BETTE TATUM, CHAIRMAN, GOVERNOR'S SMALL BUSINESS ADVISORY COMMITTEE, AND STATE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

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Over 95% of our Hawaii businesses are small, so a healthy Hawaii economy depends greatly upon a healthy small business community. Acknowledging that fact, the state government and the small business community are making positive strides in Hawaii—especially during the past two years.

One month ago we held our Third Annual Statewide Small Business Conference. As in the first two conferences, between 400 to 600 small business people from throughout the state attended, with many of them participating in our workshops and open forums. We are especially pleased that this year over half of our state legislators attended and many of them, too, participated. Also, many state department directors also participated. In a recent national survey, our Conference was given a number one rating.

Hawaii is the only state, we understand, with a small business coalition, made up of all small business organization, working together for more than one legislative session. We are now starting our third session with our goal continuing to be communication and awareness between government and small business.

One year ago Governor Ariyoshi appointed Hawaii's first Small Business Advisory Committee. A national survey of small business assistance in the states ranked our Committee, along with Tennessee's, as number one in the nation in effectiveness.

Last summer the Governor appointed another committee—the Governor's Committee on Doing Business in Hawaii—to delve into Hawaii's strengths and weaknesses as a business location. We were mandated to have a report to the governor before the 1984 legislative session and we did that. The report, along with recommendations, is on his desk.

Because of your apparent interest in our small business concerns by flying thousands of miles to visit us, I am attaching for your information Hawaii's 1983 Statewide Small Business Conference ballot results to give you an idea of our state level concerns.

As to the Federal level, we share the mainland small business concerns: skyrocketing payroll taxes, need for Reg Flex expansion, reauthorization of Equal Access to Justice, increased paperwork reduction, exempting small contractors from Davis-Bacon regs, expanding private sector contracting, allowing federal purchasing offices to buy from local businesses when cost effective, and allowing small firms to borrow from their pension funds.

Then we're also interested in your committee member Joseph Addabbo's bill, Chairman Mitchell, considered major small business legislation to retool the nuts and bolts of obtaining government contracts. That bill, as well as your committee member Toby Roth's and Senator Alan Dixon's bill along the same lines appears to be good news for small business. I congratulate you for finessing your bill past the Armed Services Committee recently.

Also on the subject of government procurement, Hawaii's Senator Dan Inouye informed us recently that he is preparing a pamphlet for Hawaii's small business community about opportunities to sell goods and services to the federal government. Getting the news out to the businesses is a good first step.

To give you specific problems small concerns encounter in Hawaii regarding the federal government, I've brought with me today NFIB member Helga Mavael and Joe Donaghy. Helga is from Honolulu, but Joe traveled to Honolulu from his home on Maui today for the express purpose of appearing before you.

Thank you, and do have a relaxing stay in our Hawaii Paradise.

ATTACHMENTS

1. Hawaii's Statewide Small Business Conference Program.
2. Statewide Small Business Conference Ballot Results.
3. Survey on Small Business Assistance Efforts in the States.

1983
STATEWIDE SMALL BUSINESS CONFERENCE

Ballot Results

Over 400 small business people throughout the state attended the third annual Statewide Small Business Conference. Six workshops were conducted and thirty areas of concern emerged from those six workshops. The attendees were asked to vote for their top ten areas of concern. The results are:

(In order of priority)

1. The injury or sickness must be directly related to employment by the employer workers' comp is being charged against.................................. 64%
2. The pyramiding effect of the State General Excise Tax should be eliminated........................... 64%
3. The waiting period to collect workers' compensation benefits should be lengthened to 7 working days with limited retroactivity......................... 59%
4. Hawaii should uniformly apply the federal income tax tests for determining independent contractor status (versus employee status) in all areas, so business people will have greater freedom to contract for services.............................. 49%
5. The presumption of compensability (presumption clause) should be amended to remove the unfair burden of proof upon employers and changed to a "preponderance of the evidence."................... 48%
6. Incumbent state legislators should be prohibited from practicing as lawyers or advocates before agencies in the executive branch just as members of Congress may not practice before federal agencies 47%
7. Fifty percent of the legally required TDI, prepaid health and workers' compensation costs during an employee's first year of employment with a company should be a tax credit.............. 45%
8. A one-stop license and permit center, as well as a centralized forms management center, should be set up in a state office to ease the regulatory burden small businesses now encounter.............. 42%
9. The state and counties should pay their bills within 30 days or pay interest..................... 41%
10. Hawaii should consider the establishment of a workers' compensation "wage-loss" system (similar to Florida's) and modified to fit Hawaii special needs and purposes........................ 40%

11.	Workers' compensation employer premiums and employee benefits should have realistic maximum limits	39%
12.	The Governor's Small Business Advisory Committee should be mandated to develop a master plan to promote small business development in the State of Hawaii	37%
13.	(Tie) In consideration of frequent complaints regarding fraudulent claims for workers' compensation benefits, a special fraud unit should be established to crack down on those who do not deserve payments	35%
13.	Entirely eliminate the presumption clause in workers' compensation	35%
14.	The state legislature should enact Equal Access to Justice to make sure small businesses may collect their legal costs, fees, and expenses from state government if the small business prevails in a civil legal action brought by the state	34%
15.	Provide for a deductible on workers' compensation to reduce premium costs	33%
16.	If there is a controversy concerning the work status of an individual, the claimed employer should not be required to pay the tax or contribution assessment in advance as a pre-condition to exercising its appeal rights	30%
17.	Require private sector contracting for goods and services when cost-effective	26%
18.	The State Department of Commerce and Consumer Affairs should eliminate the two-day expedited processing charge for filing of articles of incorporation and similar documents and instead should speed up the process for all applicants	25%
19.	If Hawaii does not adopt the more liberal federal income tax tests for determining independent contractor status, it should enact a special exemption for all "direct sellers" allowing them to be treated as independent contractors similar to IRC Section 3508	18%
19.	(tie) Vocational Rehabilitation specialists should be licensed	18%
20.	(tie) The period for retroactive assessment and determination of unemployment compensation adjustments should be reduced two (2) years	15%
20.	Tighten the administrative procedure laws (rules and regulations) toward a clarified consistent application of the law	15%

21.	Cases for termination of employment shall be beyond the jurisdiction of the circuit courts except for actions arising solely under current laws prohibiting employment discrimination..........	14%
22.	Legislation should be passed to help shorten processing time in obtaining business license.......	13%
22.	(Tie) Deregulation of employer-employee matters should be undertaken by a state commission modeled after the Deregulation Commission of the Reagan Administration...............................	13%
23.	Cost of prepaid health for employees with more than one job shall be borne by the employer offering the hours in preceding month...............	11%
24.	A small business liaison office in the governor's office should be created with existing state personnel...	9%
25.	Establish a fee schedule for vocational rehabilitation expenses............................	8%

THIRD ANNUAL

STATEWIDE SMALL BUSINESS CONFERENCE

Sponsoring Organizations:
The Chamber of Commerce of Hawaii
Hawaii Business League
National Federation of Independent Business (NFIB)
Small Business Hawaii
U.S. Small Business Administration

FRIDAY, OCTOBER 21, 1983
7:30 am - 4:15 pm
Hawaiian Regent Hotel
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Honolulu, Hawaii

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CONFERENCE SCHEDULE

• MORNING

7:30 **REGISTRATION & COFFEE**
Regent Ballroom Foyer

8:30 **U.S. Pacific Fleet Band & Joint Services Color Guard**
Regent Ballroom

8:45 **OPENING PROGRAM**
Regent Ballroom
Introduction of Governor:
Anthony Pellegrino, *Small Business Council, Chamber of Commerce of Hawaii*
Welcome: Governor George R. Ariyoshi
Explanation of Program:
Dick Waidzunas, *U.S. Small Business Administration*

9:00 **STATUS REPORTS**
to *Regent Ballroom*
9:20 **Unemployment Insurance:** Robert B. Robinson, *Chamber of Commerce of Hawaii*
Taxes: Lowell Kalapa, *Tax Foundation of Hawaii*
Workers' Compensation: Tim Lyons, *Hawaii Business League*
Professional/Vocational Licensing: Steve Walsten, *Hawaii Business League*
Cutting Red Tape: Bette Tatum, *National Federation of Independent Business (NFIB)*
Employer/Employee Laws: Jared H. Jossem, *Attorney*

9:40 **WORKSHOPS**
to **Workers' Compensation:** Tim Lyons, *Regent*
10:30 *Ballroom*
and **Prompt Payment, Court Costs, Private Sector Contracting, & Rules and Regs:** Bette Tatum,
10:40 *Nuuanu Room*
to **Employee or Independent Contractor:** D.
11:30 Aiden Newland, *Attorney, Manoa Room*
Hawaii's Pyramid Tax: Alan S. Konishi, *Chamber of Commerce of Hawaii, Makiki Room*
Small Business Development Programs: Tookie Evans, *Chamber of Commerce of Hawaii, Hau Room*
Labor Laws: Jared H. Jossem, *Ohia Room*

11:30 **NO HOST COCKTAILS**
Hawaiian Ballroom
MOVIE: *Small Business, The Last Frontier*
Hawaiian Ballroom

11:50 **LUNCHEON**
Hawaiian Ballroom
Master of Ceremonies: Phil Whitney, *Small Business Hawaii*
Blessing: Rev. Mealii Kalama
Introduction of Head Table: Phil Whitney
Introduction of Department Directors, Legislators and Keynote Speaker: Bette Tatum
Keynote Speaker: James D. "Mike" McKevitt, *Director of Federal Legislation, NFIB*

• AFTERNOON

1:30 **BALLOTING:** Tim Lyons, *Regent Ballroom*

2:00 **OPEN FORUM: Department Directors &**
to **Legislators**
2:50 Mary G. F. Bitterman, *Department of Commerce and Consumer Affairs, Manoa Room*
and Joshua C. Agsalud, *Department of Labor and Industrial Relations, Nuuanu Room*
3:00
to Joseph K. Conant, *Department of Housing and*
3:50 *Community Development, Ohia Room*
George Freitas, *Department of Taxation, Hau Room*
Mike Tokunaga, *Department of Accounting and General Services, Makiki Room*
Kent M. Keith, *Department of Planning & Economic Development, Regent Ballroom*

4:00 **RESULTS OF BALLOTING:** Tim Lyons, *Regent Ballroom*

4:15 **ADJOURN**
NO HOST COCKTAILS; *Regent Ballroom Foyer*
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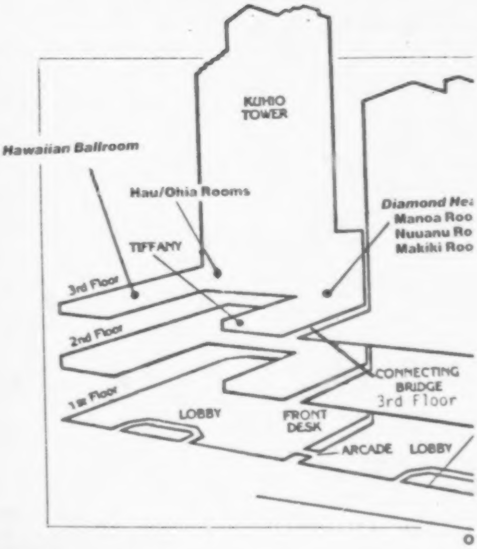
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Hawaiian Ballroom
Hau/Ohia Rooms
TIFFANY
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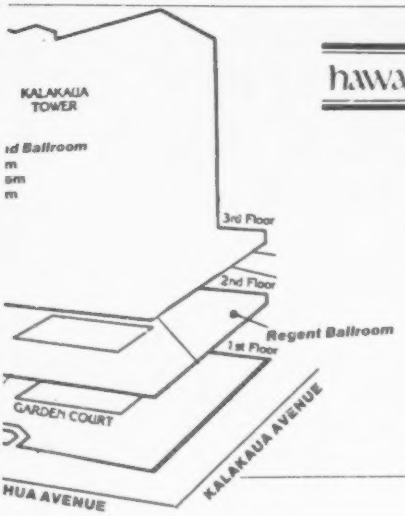

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HAWAIIAN BALLROOM – 3rd Floor
Koa Room
Kamani Room
Kukui Room

DIAMOND HEAD BALLROOM – 3rd Floor
Manoa Room
Nuuanu Room
Makiki Room

MEETING ROOMS—
Hau Room – 3rd Floor
Ohia Room – 3rd Floor
Hala Room – 1st Floor

GUEST HOSPITALITY ROOM
Regent V – 1st Floor

Kalakaua Tower

REGENT BALLROOM – 2nd Floor

MEETING ROOMS
Kona Room – 2nd Floor
Regent III – 3rd Floor

GUEST HOSPITALITY ROOM
Regent IV – 4th Floor

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WORKSHOPS

WORKERS COMPENSATION

Tim Lyons, *Moderator*

Tom Hopcroft, *Hawaii Insurance Rating Bureau*
David Walker, *Fireman's Fund Insurance*
John Cavanah, *Cavanah Associates*

PROMPT PAYMENT, COURT COSTS, PRIVATE SECTOR CONTRACTING, & RULES AND REGS

Bette Tatum, *Moderator*

Gary Barron, *U.S. Small Business Administration*
Desmond Byrne, *Computab*
Tony Chang, *State Senator*
Bert Kobayashi, *State Senator*
Michael Lilly, *First Deputy Attorney General*
Kate Stanley, *State Representative*

HAWAII'S PYRAMID TAX

Alan S. Konishi, *Moderator*

Lowell Kalapa, *Tax Foundation of Hawaii*
Jim Watts, *CPA*

SMALL BUSINESS DEVELOPMENT PROGRAMS

Tookie Evans, *Moderator*

Sam Slom, *Small Business Hawaii*
Dick Waidzunas, *U.S. Small Business Administration*

LABOR LAWS

Jared H. Jossem, *Moderator*

Ronald C. Brown, *University of Hawaii's School of Law*
Susan M. Ichinose, *Mukai, Ichiki, Raffetto & MacMillan*
Wesley Fujimoto, *Torkildson, Katz, Jossem & Loden*

EMPLOYEE OR INDEPENDENT CONTRACTOR

D. Alden Newland, *Moderator*

Ernest C. "Carey" Moore, *III, Torkildson, Katz, Jossem & Loden*

OPEN FORUMS

BITTERMAN

Tookie Evans, *Moderator*

Mary G.F. Bitterman, *Director, Department of Commerce and Consumer Affairs*
Steve Cobb, *State Senator*
Mits Shito, *State Representative*

CONANT

Dick Waidzunas, *Moderator*

Joseph K. Conant, *Director, Department of Housing and Community Development*
Mazie Hirono, *State Representative*
Patsy Young, State Senator

FREITAS

Phil Whitney, Moderator

George Freitas, *Director, Department of Taxation*
Ken Kiyabu, *State Representative*
Bert Kobayashi, *State Senator*

AGSALUD

Tim Lyons, Moderator

Joshua C. Agsalud, *Director, Department of Labor and Industrial Relations*
Eloise Tungpalan, *State Representative*
Neil Abercrombie, *State Senator*

KEITH

Bette Tatum, *Moderator*

Kent M. Keith, *Director, Department of Planning and Economic Development*
James Aki, *State Senator*
Calvin Say, *State Representative*

MURAKAMI

Tony Pellegrino, *Moderator*

Mike Tokunaga, *Deputy Director, Department of Accounting and General Services*
Richard "Scotchy" Henderson, *State Senator*

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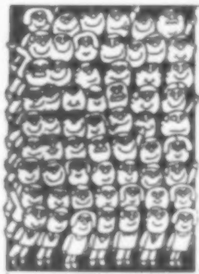
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JAMES D. "MIKE" MCKEVITT *Keynote Speaker*

James D. "Mike" McKevitt is Director of Federal Legislation for the National Federation of Independent Business (NFIB).

McKevitt, an outspoken champion of small business, is often quoted on small business matters in weekly news magazines, wire service stories and major newspapers. He is a frequent guest on TV news and public affairs programs.

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NAME

ADDRESS

PHONE

Mr. MITCHELL. Thank you, and before we hear from your compatriot, it is nice you wanted to congratulate me on the handling of the legislation with regard to the Armed Services Committee. I wish I could take full credit for that. I cannot. This was a very adroit move on the part of several of the people, but at least we have gotten it past that barrier.

Ms. TATUM. That was good.

Mr. MITCHELL. Yes.

TESTIMONY OF JOE DONAGHY, PRESIDENT, MAUI LIGHT HOUSE, INC.

Mr. DONAGHY. Thank you, Bette.

Chairman Mitchell, Members of Congress, and guests, I am Joe Donaghy, president of Maui Light House, Inc. Among other things, we are licensed electrical contractors here in this beautiful Aloha State, and also senior partner in a local travel agency on Maui.

I have been involved in the business community for the past 13 years, as officer of our local community association, past president of our PTA and member of various boards and commissions for the County of Maui.

Currently I am an action council member of the National Federation of Independent Businesses, president elect of the Maui Contractors Association, treasurer of the Maui Chamber of Commerce, vice chairman of the Board of Code Appeals for Maui County and nominated president for the State Association of Retail Travel Agents. I give you this information not as a campaign platform for public office, but to express my concern and interest in our community.

Incidentally, I would like to state for the record that the following is the expressed opinion of myself and not those of the associations I have previously mentioned.

I would like to take this opportunity to bring to your attention a grave misuse of Federal funds. I am referring to a Federal law that forces me, as an independent contractor, to charge escalated wage rates when working on Federal projects. By escalated, I mean 2.5 times the rate charged when working in the private sector. To term this misuse is putting it mildly, it is more like legal rape of the taxpayers' money.

The law I am referring to is known as the prevailing wage law, more commonly known as the Davis-Bacon Act. Apparently our legislators have an objection to reasonable wage rates; if they didn't, a law of this nature would not exist today. Various laws and commissions have been established by our Government to prevent unjust price fixing.

According to the World Book Encyclopedia, the Fair Trade Commission is an independent U.S. Government agency that works to, one, maintain free and fair competition in our economy and, two, protect consumers from unfair and misleading practices. It is a shame the people of our country do not qualify as consumers; if they did, then such a permissive abortion of their tax dollars would not exist today.

The Federal Antitrust Act was established to prevent price fixing and anticompetitive acts. Yet Davis-Bacon lives on.

It appears to me that the Federal Government feels that by paying more, you get better. This was not the case during the recent investigation of the Defense spending for miscellaneous military parts, where we purchased standard nuts for $110 apiece.

I can assure you it is not the case in Federal construction contracts. In 1981 I completed two ballfield lighting jobs for the county of Maui. The jobs were inspected, approved, and accepted by our county officials. One year later, upon being awarded another county contract for a similar job, my bid was challenged by the electrical union for noncompliance of Chapter 104 Hawaii Revised Statutes, the sister law of the Davis-Bacon Act here in Hawaii.

I was forced to pay my men in excess of $2,500 in back pay for the jobs already completed. I was also forced to charge in excess of 2.5 times the manhour rate on this new project than I would normally charge.

Naturally, I did comply with this archaic law, and you know a funny thing happened, or didn't happen, the bulbs did not get any brighter, the circuit breakers did not work any more efficiently, and there was no decrease in the resistance of the wires. The only result was more money in my pocket, which I was forced to rape from my county treasury.

On the Congressional Record of proceedings and debates of the 97th Congress, May 13, 1982, in observance of National Small Business Week, a good friend and U.S. Senator from Hawaii, Spark Matsunaga, made comments on the important roles being played by small business. I would like to read highlights of this presentation and including what I consider a very appropriate phrase.

Along with very accurate statistics, Senator Matsunaga states, "Small business stimulates competition in the marketplace"—except when dealing with the Federal Government—"helps reduce inflation"—except in the case of Federal contracts; "provides consumers with a wide choice of high quality goods and services at reasonable and competitive prices"—except when contracting with the Federal Government.

He goes on to list problems facing small business such as tax structure, regulatory policies, and Government paperwork. One he mentions is "anticompetitive practices by large corporations." My good friend, you cannot blame large corporations for doing what Federal Government promotes.

During this era of Government deregulation, many problems face us in the travel industry. We have been forced to restructure our entire marketing programs. The same holds true for the entire transportation industry, finance and communication industries. We have faced these problems, made these changes, and we will survive.

Maybe it is time we deregulate organized labor and let them compete fairly in the open market. The ability to change these laws proves that we are free people with the power to decide our destiny, and destiny, according to William Jennings Bryan, is not a matter of chance, but a matter of choice.

Any group or organization that chooses to seek shelter from fair competition under such regulatory protection is no better than those convicted of welfare and food stamp fraud.

The Davis-Bacon Act is enforced for the protection of a few organizations at the expense of every taxpayer in our Nation. The desperately needed changes now being considered will have a positive effect on many. Total repeal would benefit all.

Our choice is clear, your power will decide for us. May you have the wisdom to choose wisely.

Thank you.

[Mr. Donaghy's prepared statement follows:]

PREPARED STATEMENT OF JOE DONAGHY, PRESIDENT, MAUI LIGHT HOUSE, INC.

My name is Joe Donaghy, President of Maui Light House, Inc. Among other things, we are licensed electrical contractors here in this beautiful Aloha State, and also senior partner in a local agency on Maui.

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Naturally, I did comply with this archaic law and you know; a funny thing happened or didn't happen, the bulbs did not get any brighter, the circuit breakers did not work any more efficiently, and there was no decrease in the resistance of the wires. The only result was more money in my pocket which I was forced to rape from my county treasury.

On the Congressional Record of Preceedings and Debates of the 97th Congress, May 13, 1982, in observance of national small business week, a good friend and U.S. Senator from Hawaii, Spark Matsunaga, made comments on the important roles being played by small business. I would like to read highlights of this presentation, and including what I consider a very appropriate phrase. Along with very accurate statistics, Senator Matsunaga states "small business stimulates competition in the market place"—except when dealing with the Federal Government—"helps reduce inflation"—except in the case of Federal contracts. "Provides consumers with a wide choice of high quality goods and services at reasonable and competitive prices"—except when contracting with the Federal Government. He goes on to list problems facing small business such as tax structure, regulatory policies, Government paper work. One he mentions is "anti-competitive practices by large corporations." My good friend, you cannot blame large corporations for doing what Federal Government promotes.

During this era of Government deregulation, many problems face us in the travel industry. We have been forced to restructure our entire marketing programs. The same holds true for the entire transportation industry, finance, and communication industries. Maybe it's time we deregulate organized labor and let them compete fairly in the open market. The ability to change these laws prove that we are free people with the power to decide our destiny, and "destiny" according to William Jennings Bryan, "is not a matter of chance, but a matter of choice."

Any group or organization that chooses to seek shelter from fair competition under such regulatory protection is no better than those convicted of welfare and food stamps fraud.

The Davis/Bacon Act is enforced for the protection of a few organizations at the expense of every tax payer in our Nation. The desperately needed changes now being considered will have a positive effect on many. Total repeal would benefit all.

Our choice is clear, your power will decide for us. May you have the wisdom to choose wisely.

Mr. MITCHELL. Thank you very much. I don't have any questions. I just want to make a brief statement.

You have indicated that your testimony is your own individual thinking, but I believe it also is the position of the National Federation of Independent Businesses, they want to repeal the Davis-Bacon Act.

Mr. DONAGHY. I believe it is, but I cannot speak for them.

Mr. MITCHELL. As a part of their policy.

No. 2, I assume you are familiar with the history of the Davis-Bacon Act.

Mr. DONAGHY. Very much so.

Mr. MITCHELL. Why it came into being.

I would hope that your familiarity with it might cause you to revise your testimony just a little bit. You mentioned in your testimony defense spending, the terrible abuses that have taken place there, and indeed there are terrible abuses, but I have a great deal of difficulty relating those abuses to the existence of the Davis-Bacon Act.

Finally, you point out what has been achieved by deregulation, and I support deregulation in many instances, but it is very interesting to hear the airlines now coming in saying "Maybe we need some regulations back in place before we collapse." I wanted to make that statement because your testimony is very, very strong against the Davis-Bacon Act, but I think members of this panel ought to be aware and are aware of some of the other side of the coin.

I have no questions of either of you. Do other members?

Mr. Hayes.

Mr. HAYES. I just want to make a comment I think it is as good a time as any for us to have our 10-minute break.

Mr. DONAGHY. If I can add one thing——

Mr. HAYES. If I could finish, being a trade unionist over the years, you know, one who has seen other groups in our society seek all kinds of protection for whatever, and you for 13 years from what I see in your testimony must have done quite well in business from a number of affiliations you have.

I am not surprised at your position in opposition to the Davis-Bacon Act, and I am not here to defend it, but I must say there are some things we have to have as protection for workers, as people, as well as other facets of our society. Farmers have no reservation at all about seeking protection for their businesses, and I think working people have to have similar protection.

Whether or not you agree with Davis-Bacon is another thing. But you haven't done too badly from what I can see in your 13 years.

Mr. DONAGHY. I have done very well, thank you, and it is to me foolish to be allowed to charge the private sector any rate I desire as long as I meet the State requirements for minimum wage and then be forced to charge either Federal or State governments 2½ times that rate because the law says you will charge that. The point I am making is you do not get any better job by raping the taxpayers of their funds.

Mr. HAYES. I don't know what percentage of the tax dollars you talk about collecting as a result of Davis-Bacon on what might have remained in the Federal treasuries. I don't know that.

Mr. DONAGHY. If you don't know, I would highly suggest you look into it, sir, because it is atrocious.

I would like to add, I lost my place in my testimony, one sentence I did completely pass up was from all reports I have read from the top economic advisers, deregulation has definitely had a positive impact on our Nation's economy.

Mr. MITCHELL. Again, I will reiterate by saying in many instances I support deregulation, but I think we have to be very careful in going whole hog in one direction. I merely cited the airline industry which now says, "Look, we are in trouble and maybe we should not have deregulated." I am just trying to give some sense of balance for the benefit of the members of the committee.

We will stand in recess until 12:30. All the witnesses who are here and want to testify will indeed be heard. We thank both of you very much for taking your time to be with us today.

Mr. DONAGHY. Thank you.

[A short recess was taken.]

Mr. MITCHELL. We would like the hearing to resume. I am sorry we are late in resuming. I said 12:30 and it is now 12:31. I apologize.

I also apologize that Congressman Savage had to leave us. I hope he can get back with us. It is my optimistic prediction we should be able to complete this last part of the hearing within an hour.

I would like to call on our next two witnesses, Lowell Kalapa, director of the Tax Foundation of Hawaii, is he here?

He is not.

Mr. James E. Watts. He is not here.

Mr. Lyons, please. I will ask you to introduce the supporting troops.

TESTIMONY OF TIM LYONS, DIRECTOR, THE LEGISLATIVE CENTER, ACCOMPANIED BY DARRELL CHOY, PRESIDENT, HAWAII PEST CONTROL ASSOCIATION, AND WALLY MIURA, HAWAII FLOORING ASSOCIATION

Mr. Lyons. Thank you, Mr. Chairman, I would like to introduce the people with me. On my left is Darrell Choy, president of the Hawaii Pest Control Association, and you have met Wally Miura with the Hawaii Flooring Association.

I am Tim Lyons, director of The Legislative Center. TLC is a multiple association and legislative management firm for small business and specialty trade organizations.

TLC acts as the administrative arm for the Hawaii Business League, a 1,200-member organization composed of all types of small businesses throughout the State; the Hawaii Flooring Association, an organization composed of approximately 75 contractors, suppliers, and manufacturers in the floorcovering industry; the Hawaii Roofing Contractors Association, an organization of approximately 50 roofing contractors and suppliers; the Mason Contractors Association of Hawaii, an organization composed of approximately 85 cement and concrete suppliers, manufacturers, and contractors; and the Hawaii Pest Control Association, a statewide organization composed of approximately 45 pest control and fumigation operators.

Let me summarize my statement to say that we think the biggest problem we face overall from all types of businesses in the State is that of accessibility of Federal Government personnel. By that I mean whether it is due to budget constraints or restraints or cutbacks it seems that the majority of comments which we receive from our members as a result of circulating a memo on this hearing, all centered on the difficulty in obtaining straightforward answers in a timely fashion from Federal Government officials. As you are aware, we are part of the headquarters of district 9 in San Francisco, and as a result of personnel cutbacks most inquiries seem to result in "I don't know the answer; I'll have to check with San Francisco and get back to you."

That leads us to believe we are left with primarily clerical-type people not totally informed on the regulations.

For example, we recently requested from the Office of Federal Contract Compliance a brief synopsis of the DDO laws particularly for distribution to our members that did not previously do Federal Government work that would afford them that opportunity. The first thing we got of course was a delay of about 4 weeks saying the information had to come from San Francisco. When it did come they sent us a copy of the Congressional Record which detailed the floor debate on some of these actions which really did not help too much. A second request was a 50-page-plus document covering the history of the law, and while that would have been extremely helpful for a historical analysis, it certainly was not something we could forward to our members that would give them a clear understanding of the law.

As another example of our plea for increase in response time and better communications throughout the Federal Government network, this committee may be aware, and it was referenced earlier, a law passed by the 1983 Hawaii State Legislature that requires contractors to meet the same contractor licensing requirements that Hawaii contractors have to meet when they perform work for the Federal Government. At this point some 5 months after effective date of the law, there are varying interpretations of that law. Some Federal agencies are following it, some Federal agencies are waiting for an opinion from Washington or San Francisco, some agencies are saying they have had no word on the law, never heard of it before, and therefore they are not following it, while other agencies are contacting our office and asking for a copy of some law they just heard about the other day.

We are increasingly concerned about the lack of communication and the accessibility of Federal Government personnel to Hawaii's small businesses. Small businesses that deal with the Federal Government must be able to receive prompt, accurate information, if Government is to get the best price for its goods for its services. In that vein we would recommend that in the absence of some new source of funding for the Federal Government that a WATS line be authorized for Federal agencies which are not properly staffed locally. It would appear that through the utilization of a WATS line, small business owners could make their inquiries as well as order particular forms, rules, laws, and regulations which affect them on a more timely basis. We may be able to eliminate the step there and get our questions answered in a timely fashion.

It is not uncommon at least in Honolulu to approach the IRS office 2 or 3 weeks in advance of the tax payment deadline only to find out they are out of the form, and by the time they get the form to you 6 weeks later your taxes are overdue and delinquent and you have the penalties. That information is all sent to us by surface mail or on the slow boat, and we do not get that information very rapidly.

I would also like to just comment that as an example of the chairman's desire to see increased State authority to point out the example of OSHA when it was first passed was administered by the Federal Government in Hawaii. They had some particular problems such as the requirement of fire extinguishers and where they are mounted, and Federal law is 6 feet and Hawaii is 5 feet because our people are shorter, and that is true. Nevertheless, the Federal Government could not enforce OSHA very well and of course OSHA is not necessarily a friend of small business, but it is a necessary evil that we have to have. As a result the State opted to administer their own OSHA plan as Congress had allowed for in subsequent years, and Hawaii has now administered its own OSHA program for quite some time. The only confusion that we have is any time the Federal Government or OSHA makes an administrative change, we read about it in the papers because our press picks it up, it does not apply to us until our local law is changed. That program at least has worked well to the extent that it is controlled locally, and the laws, the rules, and the regulations are made locally and they apply to us in a local condition, and we do not have to worry about regulations that do not have bearing on Hawaii such as snow-bearing equipment and such.

Also, I would like to just let you know that you had inquired as to small business set-asides, which I believe was more the subject of

Mr. Savage. However, to my knowledge there is no small business set-aside program in the State of Hawaii. A bill has been introduced in several sessions which did not see the light of day. There was a hearing on the bill but it was subsequently killed. Therefore, we do not have any such small business set-aside program.

We have considered the raising of the dollar limit for bid work to follow the Federal law which is now up to $25,000; the State is still down at $8,000. In consideration of inflation there have been bills in the last session and prior to that to increase that to $10,000 and even $15,000. Those bills have not passed. The only thing we have locally is a Hawaii Product Preference Act which gives local bidders on State jobs a 5-percent differential assistance in effect as long as all goods are made locally and manufactured locally.

You commented earlier as well on the workers' comp situation, and for Mr. Hayes information, Hawaii unfortunately has the distinction of being No. 1 in the Nation as far as workers' compensation costs go. The last figures I saw, I do not remember them exactly, but per $100 of payroll——

Mr. MITCHELL. Can I interrupt just 1 second?

Mr. LYONS. Surely.

Mr. MITCHELL. Please go right ahead. Forgive me. We had a little bit of mechanical things we had to work out.

Mr. LYONS. I was only saying our workers' compensation is No. 1 in the Nation, and the last figures I saw showed that Illinois as a matter of fact was the lowest in the Nation at 73 cents per $100, and Hawaii was closer to $3.80 per $100. That is an average figure, and as previously testified to some people pay as high as $10 per $100 of payroll. That fringe benefit exceeds it. It is a local problem that the legislature will be wrestling with, hopefully next session, but the sooner the better.

Also, one of the points is that as far as the discussion on the differential between outside contracts coming in, Hawaii does have unique laws. We are, as you probably are aware, the only State that has a prepaid health care law which forces all employers to pay for their employees' health insurance. I do not particularly want to comment on the good or bad of that law; it is a cost overhead that local contractors have to pay that mainland contractors may or may not have as well as the 4-percent tax talked about.

The other thing, in circulating our memos as far as difficulties with the Federal Government, we received several comments along the line of small business set-aside programs for the Federal Government regarding the burden that falls on the contractors who are bidding to challenge another bidder, presumably the low bidder, of their size standard. Our difficulty there of course is one competitor does not know the gross volume of another competitor, and it is up to the contracting officer to do the disqualification which in our mind is just not workable. I do not think Mr. Choy knows Mr. Miura's profit and loss statement more than I do, and certainly they are not in a position to challenge it with any facts and figures. That is still a problem for us. Thank you.

[Mr. Lyons' prepared statement follows:]

PREPARED STATEMENT OF TIM LYONS, DIRECTOR, THE LEGISLATIVE CENTER

I am Tim Lyons, Director of The Legislative Center. TLC is a multiple association and legislative management firm for small business and specialty trade organizations.

TLC acts as the administrative arm for the Hawaii Business League, a 1200 member organization composed of all types of small businesses throughout the state; the Hawaii Flooring Association, an organization composed of approximately 75 contractors, suppliers and manufacturers in the floorcovering industry; the Hawaii Roofing Contractors Association, an organization of approximately 50 roofing contractors and suppliers; the Mason Contractors Association of Hawaii, an organization composed of approximately 85 cement and concrete suppliers, manufacturers, and contractors, and the Hawaii Pest Control Association, a statewide organization composed of approximately 45 pest control and fumigation operators.

On behalf of the above organizations I would like to express my personal appreciation to the Committee for taking the time to come to Hawaii in order to share our concerns and views. It is not often that we are afforded this opportunity and we truly appreciate the members of this committee taking the time to hear our problems.

In preparation for this hearing we circulated a memo to the respective members of these organizations asking for their input and comments. While there were some specific individual problems identified it seemed that most parties were concerned with the accessabilty of federal government personnel for questions and problem resolution. As you are aware Hawaii is part of District 9, headquartered in San Francisco. Due to what is apparently budget cutbacks most supervisory personnel have been moved to San Francisco or their previously Honolulu based job has been eliminated. As a result, we have found on many occassions where local federal employees are not able to answer the questions based on their unfamiliarity with the problem and indicate that they must ask San Francisco and get back to us. This results in two to four week delays.

As an example we recently requested from the Office of Federal Contract Compliance (OFCCP) a brief synopsis of the law so that we could circulate all the requirements to our members who had previously not done federal work. At first we were informed that this information would have to come from San Francisco, and upon receipt it was a copy of the Congressional Record detailing the floor debate for passage of the law. A second request resulted in a 50+ page document covering the history of the law including actual copies of the many executive orders. All this information is helpful for a historical analysis, but it certainly was not something we could distribute to our members to give them an effective clear understanding of the law.

As another example of our plea for an increase in response time and better communications throughout the Federal government network, this Committee maybe aware that the last session of the 1983 Hawaii State Legislature produced a new law which requires contractors who perform work for the federal government to meet the contractor licensing requirements of the Hawaii law.

At this point, some five months after the effective date, there are varying interpertations of that new law. Some Federal agencies are following it, some federal agencies are waiting for an opinion from Washington or San Francisco, some agencies are saying that they have had no word on the law therefore, they are not following it, while still other agencies are contacting our office asking for a copy of the new law which they have just heard about.

We are increasingly concerned about the lack of communication and the accessability of Federal government personnel to Hawaii's small businesses. Small businesses that deal with the Federal government must be able to receive prompt accurate information, if government is to get the best price for its goods and services. In that vein we would recommend that in the absence of some new source of funding for the federal government that a WATS line be authorized for Federal agencies which are not properly staffed locally. It who would appear that through the utilization of a WATS line, small business owners could make their inquiries as well as order particular forms, rules, laws, and regulations which affect them on a more timely basis. It is not uncommon to approach the local IRS office two or three weeks ahead of a tax payment deadline only to find out that they are out of the form and ordering by them will take 6 to 8 weeks.

For this committees information it is our understanding that your committee may take primary credit for the passage of the Regulatory Flexibility Act and the Equal Access to Justice act. We think that those two measures are of extreme benefit for small businessess and congratulate this committee for their action in this area. For your information we are currently in the process of attempting to persuade our state legislature to enact similar legislation.

In conclusion Mr. Chairman I would like to thank you again for this opportunity to provide you with comments. We would be more than happy to answer any questions that you or your committee members may have.

Thank You.

LIST OF ORGANIZATIONS

Hawaii Business League, Carol March/President/Puna Printers

Hawaii Flooring Association, Wally Miura/Political Action Committee Chairman/Wally's Flooring, Inc.

Mason Contractors Association of Hawaii, Stanley Wada/President/Quality Masons Inc.

Hawaii Roofing Contractors Association, George Matsuoka/President/Honolulu Roofing Company, Ltd.

Hawaii Pest Control Association, Darryl Choy/President/Vet's Termite, Inc.

Mr. MITCHELL. Thank you. You got an awful lot in in a short period of time. It was very, very helpful to us.

I did have some comments and questions, but I think this is the propitious time for me to sort of give you a thumbnail sketch of what a Member of Congress has to deal with. This Nation is made up of a series of competing interest groups, and that is the essence of democracy. It is fine if you are not a public figure to say well, we will take just your point of view or just your point of view but if you are an elected official then your never-ending task is to balance out the differences between competing interest groups and to arrive at a position that you think in your mind and in your heart is the best for the good of the whole country.

I make that remark because a few years ago I was roundly booed at the White House Conference on Small Business when I insisted we needed OSHA. I think the health and safety of workers has to be protected. I was the first to admit that OSHA really went berserk in terms of its nitpicking, with silly little things that it required of small businesses. I was booed equally as roundly at that conference when I said I think we need an Environmental Protection Agency. We have to keep our waters and our streams and our air as pure and clean as possible for future generations.

So it is not easy.

I make that remark only because I think that OSHA did become an enemy to small business because of its nitpicking, but conceptually if you look back on the history of this country, if you look at present-day working conditions, the asbestos problem, for example, there has to be an entity at the Federal level that is concerned with the health and safety of workers of our Nation. I think it was wise for Hawaii to come up with its own OSHA entity because you do have significantly different problems. But I would hope that the State would remain wedded to the concept that an entity is needed for the safety and for the health of the employees.

On the accessibility of Federal Government personnel, I just want to be devilish for a moment. It is at the national level where, personnel cuts have been imposed across the board in all the agencies, and I assume that those cuts were made at the request of the administration.

Honestly if you possibly can, if you have the money, if you want to take the chances, I think one of the best tactics is to go directly to the Federal agencies, put the weight right back on them, and they are going to start yelling and screaming well, why do you not see your regional or district office, and just tell them there are people there who are not satisfying us. Maybe we can alert the national agencies to realize they have gone overboard in personnel cuts, overboard in the sense of really not helping those persons or associations that need to be helped.

I am recommending that as one strategy. I know exactly what you are talking about. At a hearing some years ago, maybe no less than 2 years ago, following that hearing we had asked our staffs to get on the phone and call the various small business offices to make inquiries about direct loans and I must say I was astonished by the thespian talents of our staff. They tape-recorded the conversations, one staff member called and said I have been trying to get a loan and just cannot get one, and he was told go to the banks. He said, but I have done that, is there not some other loan? The SBA response was: "No, never heard of a direct loan program."

Obviously that is either of two things, either that is ignorance or incompetence on the part of the employee, or it is a part of a pattern to discourage use of different Government programs.

I certainly intend to submit your testimony to the Government Operations Committee. That is a committee that has the responsibility for all of the agencies of Government and make sure they are functioning properly, and it is not the first time we have heard of lack of accessibility on the part of Federal employees or ignorance or lack of knowledge on the part of those employees. We cannot let this go on. We cannot let that drift.

I think your idea about the WATS line is excellent. That ought to be taken up I guess by the Small Business Administrator and maybe with the Government Operations Committee at the same time. I am a little concerned, still a little confused, there is no State law setting aside for small or minority business. Is that correct?

Mr. LYONS. That is correct.

Mr. MITCHELL. It simply does not exist. However, there is another law that applies to contracting activities?

Mr. LYONS. Yes. That is a separate law that was effected last session, and the Governor signed it June 14, taking effect on approval, and in effect it requires that mainland contractors who perform Federal work here must meet the same requirements as local contractors. There is some precedent for that in that the bid specifications that normally go out now on Federal jobs have a statement to the effect that the contractor shall meet all local licenses, permits, codes, et cetera. Again as an example, if a moving contract now is put out for a company to move military dependents or whatever, they must have a locally issued PUC license. Again that is primarily because I assume the Government does not want this particular trucker should they not meet local requirements suddenly have a stop along the highway, the contract is not fulfilled and you have a problem with the Federal Government.

Mr. MITCHELL. This is the question: Could that law in any way be applied to the situation alluded to earlier where contractors come in and use the storage space at a military base with that advantage? Is there any way we can use that preferential law to attack that?

Mr. LYONS. There is some relationship there certainly as far as payment of workers' compensation and the statement they were just not paid. Under chapter 444 of the Hawaii revised statutes, when a contractor receives a license they must show proof of workers compensation policy. That is not done now in the Federal Government area. Their determination of responsibility generally has to do with track record. In fact the Federal Government has accepted contractors as the awarding contractor that have been rejected for a license by the State. There was of course much question about their qualifications in that case. That is indeed the exact reason why that law was passed by the legislature and the legislature saw fit to take action.

Mr. MITCHELL. We are doing it just the other way in the Surface Transportation Act. We are saying if the State says you are OK then the Federal will go along. That is just the opposite of what occurs here.

Mr. LYONS. If we apply that theory to contracts put out here I think that would probably solve our problem.

Mr. MITCHELL. What I would like very much to do is to get together with your Congressmen and other members of the committee and let us go through existing law to try to come up with amendments or exemptions or changes where it is possible. I think I would like very much to get your help on that, Congressman Akaka and Congressman Hayes. We have done this kind of thing in housing legislation where we note the cost of housing is very high in Alaska or someplace and allow certain exemptions. It might be good for us to sit down and look at all existing law that applies to small and minority businesses and to see where the uniqueness of this area lies. I am talking about the whole area, not just Hawaii, though. The uniqueness of this area would require exemptions and what they may be.

You have given us more work to do, but I think it is important that a government be responsive to you and the unique problems of your area.

Mr. LYONS. I think that would be a very fruitful course. That would help immensely.

Mr. MITCHELL. Congressman Hayes.

Mr. HAYES. I just want to comment that I appreciate the candor with which Mr. Lyons covered a lot of territory. I was very concerned and interested in regards to what you said about OSHA. I am not being necessarily partisan in my political outlook, but much of the funding that came from the Federal Government for continuation of this kind of program has been discontinued by the current administration. However, I think the attack against it which caused the administration to at least alter its position in terms of support came not necessarily from the people in the small business area who were hurting the most but from many of the big business guys who wanted to get rid of this program and ones who I guess are the polluters of our whole environment. We are trying to retain as much as we can of that program, whatever the deficiencies are. Much can be attributed to the financing mechanism of it.

As to workmen's comp, and maybe this is an unfair question to place before you, I am a little concerned about the lack of any kind of policing mechanism for people who refuse to abide by the law, and refuse to pay. You are right when you say my State of Illinois, for example, is at the bottom of the ladder when it comes to the amount they pay. But at the same time people from outside of Illinois who do business in Illinois pay that tax. I do not know why we cannot have a tightening up of the loopholes here in Hawaii and not let them get away with no taxes for workmen's comp. What can the State do to police it? These big people are responsible for doing business here in Hawaii, and what would happen if a worker would get injured? What would happen?

Then you find out there is no coverage under the insurance arrangements. These are the problems we have to look into.

Mr. LYONS. There is a lot more that could be done from the State labor side, I agree with you. Second, I think it is a private industry concern in Illinois. I believe your system is slightly different, but ours is totally privately funded. We do not have a State fund or monopolistic fund that competes. As a result, the premiums paid are paid to the contributor. Of course the contributor is the one that now has the money or does not have the money as the case may be, and in many cases it is the contractor's responsibility to notify the contributor. He should be saying, "By the way I am going to Hawaii, I should be paying their rate for the next couple weeks, et cetera." However, once you look at our rates compared to every other State, for example, in the roofing industry they now pay $4.95 per $100 of payroll. Last time I checked I believe Alabama was about $1.10. If I was a contractor I doubt if I would notify my contributor to bill me the extra $4 per $100 payroll. That is the difficulty.

Mr. MITCHELL. If you did that you would not be a very smart businessman in one sense.

Mr. LYONS. I probably would not do the job in Hawaii.

Mr. MITCHELL. I am not encouraging disregard of the law, either.

Congressman Akaka.

Mr. AKAKA. Thank you very much. I just want to say thanks to Tim and the Hawaii Business League for your testimony here and to tell you that we would be very happy to work with Chairman Mitchell in reviewing the laws on the books to see where amendments may be beneficial to small business people in all cases, especially in Hawaii.

Mr. LYONS. I appreciate that, Congressman.

Mr. MITCHELL. In that process, you brought it on yourself, we will be relying on you heavily. Obviously you are much more familiar with the nuances than we are, except for Congressman Akaka. We will be back asking for guidance as we start that review.

Mr. LYONS. It is a major problem and I would have no problem at all justifying the time to take care of it.

In clC‘ing, I might add that I understand it was this committee that was at least partially responsible for the Equal Access to Justice Act and the Regulatory Flexibility Act, and they are of extreme benefit. In fact we have similar proposals in our State legislature modeled after the national legislation, and we will follow that.

Mr. MITCHELL. Thank you for that comment. It is amazing, every Member of Congress will stand up and say I am a friend of small business; then when you introduce some legislation like equal access to justice, you will find all those folks saying, yes, I am a friend of small business, but we do not need this, or that this is in somebody else's jurisdiction. I must say every bill we got through this year and last has been a battle despite the fact that everybody stands up and says I am for small business. We will keep pushing. I hope you do the same at the State level.

Mr. LYONS. Thank you, Mr. Chairman.

Mr. MITCHELL. I thank all three of you gentlemen.

A number of witnesses had to leave and I want to indicate that their written testimony will be submitted for the record.

[The prepared statements of Messrs. Potter, Shimizu, Pellegrino, Mason, and Kalapa follow:]

PREPARED STATEMENT OF NATHANIEL R. POTTER, JR., VICE PRESIDENT OF MARKETING, LONE STAR HAWAII CEMENT CORP.

Thank you for the opportunity to testify before this group on a problem facing many small businesses in Hawaii, which is becoming more acute each year.

Business Bankruptcy has always caused suppliers to suffer as well as lending institutions. During this past recessionary period, a number of small Hawaii businesses closed their doors by declaring bankruptcy, which resulted in several supply companies being forced to follow suit due to the losses incurred.

The inequity of the existing bankruptcy system is evidenced when some of the businesses,whose closing forced the suppliers into bankruptcy, re-open under another name a short time later.

We are given to understand that a petition has been introduced to discharge from the House Rules Committee HR 3, which would revamp the bankruptcy court system. The petition would also allow an amendment which would bar debtors from declaring complete bankruptcy if they are capable of repayment.

This part of the petition has the full support of the National Chamber of Commerce and the American Retail Federation. While this measure concerns individuals, rather than companies, the majority of Hawaii's small businesses are sole proprietorships rather than partnerships or corporations; and as sole proprietors, are actually doing business as individuals with a federal employer I.D. number and a Hawaii State Excise Tax License.

As individuals, the provisions of the petition would apply to these sole proprietorship businesses.

From another standpoint, the members of the Small Business Council of the Chamber of Commerce support this petition and and any other pending legislation which would tighten the provisions for discharge of debtor obligations. Since 1979, the number of individual bankruptcy filings have risen dramatically and are now running at 200% of the rate for the 12 years prior to 1979. The severe losses caused by the lenient debtor provisions of the 1974 Bankruptcy Act, are damaging not only to the small business community, but to the consumer who ultimately pays the bill through higher prices, interest charges and restriction of credit.

Thank you

Prepared Statement of Edwin J. Shimizu

Thank you for this opportunity to testify before you today. My comments this morning will be in support of H.R. 3846, otherwise known as the Stenholm-Strangeland bill.

As you may be aware, the purpose of H.R. 3846 is to help small businesses in getting more federal government contracts. Under the existing Davis-Bacon Act -- a law that was enacted in the post-depression era -- any bid over $2,000 on a federal contract must use prevailing wages for employees as a basis of the bid. H.R. 3846 will raise the limit from $2,000 to $1,000,000 before the prevailing wages standard will be required.

In Hawaii, prevailing wages are invariably construed to mean union wages by administrative practice of contract-granting federal agencies. Our concern is that small contractors simply cannot afford to pay their employees at prevailing or union wages. Consequently, small contractors are currently precluded from bidding on most federal contracts that exceed $2,000. Raising the limit would allow small contractors to bid competitively, which could, in turn, result in some cost savings to the federal government.

The Chamber of Commerce of Hawaii

Another factor to consider is that the $2,000 limit has not been raised since the initial passage of the Davis-Bacon Act. In the intervening fifty-odd years, inflation has dramatically increased the costs of labor and materials. The present $2,000 limit virtually ensures that only insignificant federal projects will fall into the hands of small contractors. Any project of substance will trigger the prevailing wages standard, thus foreclosing the small contractor from getting in on the action. The proposed increase to a $1,000,000 limit would more realistically reflect today's costs in the contracting business.

Thank you again for allowing me to testify this morning. I will be happy to answer any questions that you may have.

PREPARED STATEMENT OF ANTHONY PELLEGRINO

Thank you for allowing me to to testify before you today. My comments today will be in opposition to H.R. 3652, a bill introduced by Representative Biaggi of New York that would increase the Federal Minimum Wage from the present $3.35 per hour to $4.15 per hour effective in 1984.

It has been estimated by the Small Business Council of the Chamber of Commerce of Hawaii that approximately 70% of Hawaii's small businesses employ one or more persons at minimum wage. The effect of a 24% increase in labor cost to these small businesses would be extremely harmful, causing some of them to discontinue operation, and many more to reduce their payroll expenses by simply terminating employees.

The probability of many small businesses reducing their payroll costs through termination is substantiated by the U.S. Chamber of Commerce which estimates that 660,000 persons became unemployed as a result of the last increase in the Federal Minimum Wage which took place over a three year period. It is recognized that the Minimum Wage Law is directly responsible large-scale teen-age unemployment, which turns eager-to-learn young people into hard core unemployed. It is respectfully requested that the members of this committee consider the far-reaching implications to Hawaii's small businesses of any measure which would increase the Federal Minimum Wage.

Thank you again for the opportunity to testify before you this morning.

PREPARED STATEMENT OF GEORGE MASON, PUBLISHER, PACIFIC BUSINESS NEWS

I am George Mason, publisher of Pacific Business News and, since December 1972, chairman of an ad hoc organization known as STOP (acronym for Shipping Tieups Over Permanently).

STOP was formed by a group of small business owners and executives one week after the last of three maritime and longshore strikes on the West Coast had severed Hawaii's lifeline for 175 days in a period of 17 months.

This organization, with the total support of Hawaii's business community, was instrumental in having bills introduced in the U.S. Senate and U.S. House in April 1973 that would have made it possible for Hawaii and other U.S. Pacific Islands to be exempted from West Coast shipping interruptions for a period of up to 160 days. That measure passed the U.S. Senate in July 1974 by a vote of 54 to 39. It did not reach a vote in the House but was the subject of at least one hearing at which a delegation from Hawaii testified.

Hawaii continues to be deeply concerned over the constant threat of shipping interruptions. Since 1946, surface shipping interruptions ranging from 2 to 177 days have profoundly affected the commerce and the lives of the people of Hawaii. In all, 82 such incidents totaled 1,582 days--or an aggregate of more than four years and three months.

Because shipping tieups are unpredictable, the fear of them is, in the long range, almost as costly as the interruptions themselves. The length of time merchandise is held in inventory in Hawaii is, generally, three times that of California businesses. This is a major contributing factor to our higher cost of living. Other states have numerous options for obtaining vital supplies: trains, trucks, ships, inland waterways, and short haul air transport. Hawaii depends solely on ships for more than 80 percent of its needs.

Two years after the last major shipping interruption, the Bank of Hawaii's business research department surveyed a cross-section of businesses who reported that their average inventory carried year-round was 103 days. Asked what their inventory would be if assured that a West Coast shipping interruption would last no longer than 10 days, the average of the replies was 68 days--or a saving of 35 days because of such assurance. That 34 percent reduction in inventory would, if extended to the entire commodity spectrum, mean a savings of hundreds of millions of dollars annually to Hawaii consumers.

No other American state would condone what Hawaii endured in 1971 and 1972 or, for that matter, the tensions created over the 28-year period in which 82 maritime and longshore walkouts occurred, 61 of them outside Hawaii.

West Coast shipping tieups are tantamount to a blockade of the 50th state. I ask you to ponder just how many days would elapse before emergency federal legislation would be enacted if the State of Illinois or the District of Columbia were shut off from 80 percent of its needs. In fact, we have vivid memories of almost instant Congressional intervention when Long Island commuter trains were struck in the early 1970s. It was bitter news for the people of a sovereign state who were experiencing high unemployment, severe shortages, and high prices because of work stoppages 2,500 miles distant.

The uniqueness of Hawaii needs Congressional attention. Only 108 of our more than 30,000 business establishments -- about 3/10ths of 1 percent -- are not classified as small business. Some small businesses would not survive another West Coast shipping shutdown, but all small firms will be hurt. And so long as the uncertainty and threat continue to overhang our economy, only a very few can thrive. Worse yet, every resident of Hawaii pays a heavy price year after year and decade after decade for what can only be called unneccesary "protection."

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PREPARED STATEMENT OF LOWELL L. KALAPA, DIRECTOR, TAX FOUNDATION OF HAWAII

I am Lowell Kalapa, Director of the Tax Foundation of Hawaii, which is a non-profit, non-partisan research organization devoted to the study and improvement of public finance and public administration of our state and local governments. Founded in 1953, the Tax Foundation of Hawaii carries on objective analysis of the major fiscal questions facing our governments today. In the past few years, our attention has turned to the federal level since efforts have been made on the state level to maintain conformity with the federal Code and out of the realization that many of the actions taken by Congress have a major impact on the government in Hawaii. Joining me today is one of my Trustees, Mr. James E. Watts, CPA, who shall be available to answer any of the technical questions you may have about the recommendations we shall make in our testimony.

The subject of today's hearing is the problems faced by small businesses in Hawaii. While your major interest may, no doubt, be in the specific area of making capital available to small business through the variety of loan programs sponsored by the Small Business Administration, we also believe that taxes and regulation remain major problems for not only small businesses but businesses in general.

We note that among the fifteen or so priority issues singled out by the delegates to the 1980 White House Conference on Small Business, about half were aimed at fiscal problems. Of the seven or eight fiscal issues, four have been addressed, more or less, by Congress since that time. These issues were:

- adjustment of the personal and corporate income tax rates;
- implementation of the Accelerated Cost Recovery depreciation system;
- reform of the Social Security system;
- easing of the estate tax burden on family-owned businesses.

Those priority issues which still demand the attention of Congress and cited by the White House Conference are:

- implementation of a tax credit for initial investment in a small business;
- business and deferral of taxes on a business rollover;
- a tax incentive in the form a Small Business Participation Debenture Program (SBPD) as a source of capital for small businesses;
- freezing the minimum wage and/or enacting a two-tier system for teenagers, seasonals, and part-time workers;
- a statutory mandate to balance the federal budget based on a percentage of gross national product.

Alternative Minimum Tax

We also submit other tax issues which we believe deserve the attention of the Congress if the intent is to ease the burden on small business. Of the changes made by the 1982 Tax Equity and Fiscal Responsibility Act, there is none as confusing as the Alternative Minimum Tax. The list of itemized deductions, separate calculations required for net operating loss carryovers, and the allowable credits present a maze of compliance problems with which even the most experienced professional would have difficulty. Whether or not clarification is effected by administrative rule or through statutory change, the need is imperative.

Indexing Capital Gains

Another tax issue that demands the attention of Congress is the indexation of capital gains. The imposition of a tax on capital gains inhibits investment generally, but most particularly investment in new or untested business ventures, many of which begin as small businesses. In the past twenty years, the United States has had the highest capital gains tax and the lowest relative capital investment of the 12 leading industrial nations. Germany and Japan, our most successful competitors, have no capital gains tax at all.

Consideration should be given to taxing capital gains only on the difference between the final selling price and the cost adjusted for inflation that occurred during the holding period and/or reducing the capital gains rate according to the length of time an asset was held.

A capital gain occurs when the value of property increases. Such a gain is realized when the property is sold at a price greater than the property's adjusted basis. The capital gains tax is then imposed on the realization received upon the transfer or sale of the property. The present capital gains tax law is based on an invalid assumption that dollars used to purchase the property earlier have the same value as an equal number of dollars at the time of sale. Therefore, should a small business decide to acquire new property by selling an existing asset, the capital gains tax penalizes the transaction by extracting the tax based on a purchase price that is now irrelevant. Careful consideration of how the capital gains tax works to the detriment of capital formation and new investment is indeed warranted.

Taxing Small Business Rollovers

Another issue that needs the attention of the Congress is the tax treatment of a sale of a business where the proceeds of that sale are used to initiate a new small business. Under the current law, the reorganization of large businesses are permitted to occur tax free; however, this treatment is not accorded to small businesses. Consideration might be given to allowing the deferral of long-term capital gains when 80% control of the small business is sold: (1) if the business continues as a small business; or (2) if the owner rolls over the proceeds into another small business.

Double Taxation of Dividends

Another tax issue which has been with us for quite some time is the double taxation of dividends. Under our current tax system, corporate profits are taxed at the source and then makes the same profits, if distributed as dividends, taxable again as personal income to shareholders. This methodology is question able to say the least.

The problem created by this double taxation not only violates the principle of equity but also causes serious and far-reaching distortions of our economic system. Another adverse effect is the separation created by the tax between the interests of the business and the interests of the stockholders. While full integration of corporate and personal income may be far into the future, at least a partial integration plan should be considered. An alternative to our current system of taxing dividends might be to provide that all dividends are deductible to corporations and is income to the recipient by doing away with the corporate and personal exclusions for dividends.

We believe the foregoing tax issues to be of vital importance to not only small business, but to businesses in general. If we are to insure that our nation retains a climate that is conducive to the formation of new small businesses, Congress must address these critical tax issues.

Other Small Business Concerns

We note that you requested that we present an assessment of specific small business problems that are being encountered in our 50th State as well as our views on available federal assistance or lack thereof. As we mentioned to counsel earlier this month, we recognize that the resources of the federal government are limited at this time and that the opportunities for the establishment of new programs are restricted. On the contrary, we do not believe that any new programs are needed, if anything, if the Subcommittee has the opportunity to visit with the small business person out there in the real world, you will find, as we have, that the biggest hurdle that Congress can overcome for the small business community in Hawaii is the amount of over-regulation by federal, state and local government.

Compliance with some of the inane, if not ridiculous, reporting requirements threaten to drown the small business person in a mountain of Potomac paperwork. Compliance with tax reporting requirements is only the tip of the proverbial iceberg. It was recently estimated that the typical cost of producing a standard business letter was somewhere between $5.70 and $7.60. Imagine what it must cost a small business to comply with the quarterly Form 990 reporting withholding and Social Security taxes the various federal and state forms for reporting unemployment taxes, employee status reports, verification of working safety and health standards, corporate returns, regulatory certifications, etc.

Believe it or not, what most small business owners are decrying today is the over-regulation and compliance requirements of all levels of government. All of these efforts eat into the productive time of the owner/manager and his workers. And as we all know, time is money. Instead of allowing our small business es the time and initiative to further the achievements of the business, government is weighing down small businesses with wasted time and motion in complying with its various rules and regulations.

In our earlier discussions with staff, we noted that while it has long been recognized that Hawaii is a capital-short state, we also noted that Hawaii's people have a marked propensity for being thrifty. Therefore while the Small Business Administration's various loan programs have been of some assistance to our community, there are many small businesses out there today that were born without the help of the SBA. In fact, it should be noted that in many cases, small businesses have chosen to ignore the SBA and its red tape in preference of finding a more facile means of starting their enterprises. Again, even in the area of financing, small businesses in Hawaii have tried to do it on their own just to avoid much of the paperwork and regulation that has become an all too familiar part of trying to deal with the federal government.

We trust that we have provided some food for thought and some suggestions that will assist in your important deliberations in Congress on how we can improve the climate for encouraging new small businesses and assisting those that have already made that courageous step out in the world. Should you have any questions about our comments, Mr. Watts and I will be pleased to respond.

Very truly yours,

Lowell L. Kalapa
Director

LLK:jad

National Tax Alert

No. 83-15

May 11, 1983

To: All Professional Personnel

Subject: Tax Planning for the New Alternative Minimum Tax

DIGEST

TEFRA completely revamped the "minimum tax" structure designed to insure that all individuals pay at least some tax. Prior to 1983 the law contained both an "add-on" minimum tax and an "alternative" minimum tax. Beginning in 1983, the "add-on" minimum tax has been repealed altogether and replaced by an expanded alternative minimum tax. By careful tax planning during the year, the potential impact of the new tax can often be minimized. The attached worksheet may be useful in facilitating this planning.

REFERENCES

§§ 55, 56 and 57, IRC, as amended by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

RIA Analysis of TEFRA, para. 111.

DISCUSSION

Overview of New Alternative Minimum Tax

TEFRA completely restructured the "minimum tax" for individuals aimed at insuring that all high-income individuals pay at least some tax. Prior to 1983 the law contained both an "add-on" and an "alternative" minimum tax. Beginning in 1983, the "add-on" minimum tax has been repealed altogether and replaced by an expanded alternative minimum tax (AMT).

The new AMT retains all of the preference items of both of the prior minimum taxes (with the exception of the adjusted itemized deduction preference) and adds the following new preference items:

1. Interest excluded under the all-savers and (for tax years beginning after '84) net interest exclusions.
2. Dividends excluded under the dividend exclusion.
3. Certain expenditures which the taxpayer expenses, in excess of the amount which would have been deductible for the year if the expenditures had been capitalized and amortized on a straight-line basis over a 10-year period (beginning with the taxable year in which the expenditures are made). These are expenditures for mining exploration costs, development expenditures, circulation expenditures, and research and experimental expenditures.

(over)

4. The bargain element in an incentive stock option on option exercise, that is, the amount by which a stock share's fair market value at exercise exceeds its option price. (Code Sec. 57(a) as amended by §201(b)). The Conferees intend that this preference not apply where there is an early disposition of the stock acquired on option exercise.

A complete listing of preferences under the new AMT is contained in the attached AMT worksheet.

The following simplified example will illustrate how the new AMT works. Assume a married executive makes $85,000 a year, has total long-term capital gains of $100,000 (of which 60% is excluded from taxable income), and other preference items of $30,000. Regular tax on taxable income of $85,000 ($85,000 salary plus $40,000 long-term capital gains) reduced by itemized deductions and exemptions of $40,000 would be $27,014.

The executive's AMT would be computed as follows:

Adjusted gross income	$ 125,000
Add tax preference items:	
60% excluded long-term capital gain	60,000
Bargain element—Incentive stock options	30,000
Total	215,000
Less "certain itemized deductions"	20,000
Alternative Minimum Taxable Income	195,000
Less exemption for married couples	40,000
Amount subject to AMT	155,000
Alternative minimum tax (at 20% rate)	$ 31,000

Total tax liability is the greater of the taxpayer's regular tax or AMT, in this case $31,000.

As indicated in the example, only "certain itemized deductions" may be deducted from AGI in computing alternative minimum taxable income (AMTI). These include the following itemized deductions:

- Casualty and gambling losses.
- Medical expenses, but only to the extent they exceed 10% of adjusted gross income.
- Charitable contributions.
- Estate tax on income in respect of a decedent.
- Qualified interest, consisting of qualified housing interest (generally, interest on a principal residence); and interest other than qualified housing interest, but only to the extent of the taxpayer's qualified net investment income for the year. (Code Sec. 55(e); S Rept. p. 110).

Note that state and local taxes and most miscellaneous deductions cannot be used to reduce AMTI.

Credits Available Against AMT

Refundable tax credits continue to reduce AMT. However, the foreign tax credit remains the only nonrefundable credit available to offset the AMT. Not allowing other nonrefundable credits (such as investment tax credit) to offset AMT means that the benefit of these credits is lost on any year to the extent that AMT liability exists, because actual tax liability will be equal to the amount of the tax compuled on AMTI despite the lower (reduced by credits) regular tax. Any such "wasted" credit is allowed as an additional carryback or carryover of the credit.

Planning Under the New AMT Structure

Taxpayers who are potentially subject to the new AMT can often plan to avoid or minimize the impact of the new tax. The first step in planning is to recognize in what circumstances there will be potential AMT liability. Generally, the AMT will not be important unless the taxpayer has substantial long-term capital gains or other preference items and is offsetting other income items by ordinary losses.

A taxpayer not having ordinary loss items, "non-qualifying" itemized deductions or non-refundable tax credits will not be subject to the alternative minimum tax merely because of large long-term capital gains. Note that the AMT rate of 20% is the same as the maximum effective tax rate on long-term capital gains. In the above case the AMT exclusion will reduce AMTI to a point whereby AMT will not exceed regular tax liability.

Where potential AMT liability is anticipated the following ways to minimize the impact of the tax should be considered:

- Control when long-term capital gains are recognized. If the AMT will likely occur in a year in which the taxpayer's regular tax liability would be small, taxpayers may wish to consider reducing long-term capital gains in order to avoid AMT liability. The following techniques may accomplish this objective:
  - Installment sales may be used to spread long-term capital gains over several years.
  - The sale of capital assets at a loss can offset current capital gains.
  - Where stock is involved, a short sale may be used to defer recognition of the gain until the next taxable year.
- Reduce or eliminate tax preference items. In addition to reducing the amount of long-term capital gain recognized or spreading such gain over several years, various elections may be possible to reduce other preference items:
  - Taxpayers may elect to capitalize excess intangible drilling costs, minimizing exploration expenses, circulation expenses and research and experimental expenses and amortize these costs over a 10-year period.

  - Taxpayers other than limited partners can avoid the excess intangible drilling cost preference by electing to capitalize their costs and amortize them over a five-year ACRS period.

  - Excess accelerated depreciation of real property and leased personal property can be avoided by electing under ACRS to use the straight-line method of cost recovery.

  - Taxpayers facing an AMT problem should generally avoid tax shelter investments in which the tax benefits derive from items of tax preference.

- Accelerate income and shift deductions. Taxpayers with fluctuating income or long-term capital gains may be subject to AMT liability only in certain years. The taxpayer in this situation should benefit, up to a certain point, from accelerating ordinary income to a year in which the AMT applies. It is important in this situation to determine how much income can be shifted before additional ordinary income will result in a higher tax.

The deferral of tax deductions can also minimize AMT liability. Both deductions used to compute AGI and the alternative tax itemized deductions provide only a 20% tax benefit to the extent that AMT is applicable. Furthermore, itemized deductions that are not AMT itemized deductions (such as state and local taxes and most miscellaneous itemized deductions) provide no tax benefit when the AMT applies.

CONCLUSIONS

Taxpayers who are potentially subject to the new alternative minimum tax may frequently minimize their liability by careful planning. Such planning includes various techniques to reduce preference items, or techniques to shift items of preference, ordinary income or deductions among various taxable years. The National Office microcomputer income tax programs facilitate this type of "what if" analysis. The attached worksheet is designed to estimate potential AMT liability.

The May issue of The Tax Planner will alert clients to alternative minimum tax planning opportunities.

Alternative Minimum Tax Worksheet
1983 and Subsequent Years

Adjusted gross income (adjusted for special AMT NOL deduction) 1 ________

Less "certain deductions":

Charitable contributions 2 ________

Total medical expenses 3 ________

10% of AGI 4 ________

Net medical expenses (3-4) 5 ________

"Qualified housing interest" expense 6 ________

Other interest expense 7 ________

Limitation

Qualified net investment income:

Gross interest 8 ________

Gross dividends 9 ________

Gross rents and royalties 10 ________

Recapture of ordinary income 11 ________

Net capital gains on sale of investment property 12 ________

Tax preferences for excluded interest and dividends 13 ________

Total of 8 through 13 14 ________

Qualified investment exp. (for AGI) 15 ________

Qualified net invst. income (14-15) 16 ________

Qualified other interest exp. 17 ________ (lesser of 7 or 16)

Total of "certain deductions" 18 ________ (2+5+6+17)

Tax Preference items:

60% long-term capital gain exclusion ________

Dividend exclusion ________

Bargain element in incentive stock options exercised ________

Mining exploration and development costs ________

Research and development costs ________

Magazine circulation and prepublication expenditures ________

Accelerated depreciation on real property in excess of straightline depreciation over the useful life or recovery period (in the case of property eligible for ACRS 15 years); ________

Accelerated depreciation on personal property subject to a lease; ________

Amortization of certified pollution control facilities (the excess of 60-month amortization over depreciation otherwise allowable); ________

Percentage depletion in excess of the adjusted basis of the property; ________

Amortization of child care facilities (the excess of 60-month amortization over depreciation otherwise allowable); and ________

geothermal wells in excess of the amount amortizable with respect to the cost, and in excess of net income from oil, gas, and geothermal production. ________

Total tax preference items 19________

Alternative minimum taxable income 20________ (1-18+19)

Exemption: Joint = $40,000; Single = $30,000, Married filing separate = $20,000 21________

Alternative minimum tax base 22________ (20-21)

Regular tax 23________

Alternative minimum tax (T x 20%) 24________

Foreign tax credit 25________

Net tax due ________ (Lessor of 23 or 24 minus 25)

Implications of and Planning For the Alternative Minimum Tax After TEFRA

By **WING K. LAU**

The author believes that careful analysis of the client's income and expenses should be made before the end of the client's taxable year so that proper courses of action can be taken to avoid or mitigate the implications of the alternative minimum tax.

Wing K. Lau, CPA, is a member of the accounting firm of Eadie and Payne in San Bernardino, California.

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I. *History and Congressional Intent*

The minimum tax concept was first enacted in 1969 with the objective that an overall minimum tax was needed to reduce the advantages derived from tax preferences: "No one should be permitted to avoid his fair share of the tax burden, to shift his tax load to the backs of other taxpayers." [1] Since its inception, the minimum tax structure has been modified by almost every tax act, including both the Economic Recovery Tax Act of 1981 and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

Prior to TEFRA, there were the add-on minimum tax under Section 56(a) and the alternative minimum tax under Section 55, which was added by the Revenue Act of 1978.[2] The Senate version of the alternative minimum tax base in 1978 would have included all tax preferences and would have eliminated the add-on minimum tax.[3] However, the Conference Committee included only the capital gain deduction and the adjusted itemized deductions in the alternative minimum tax base. The add-on minimum tax was retained for all other preferences.

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[1] H. Rep. No. 91-413 (part 1), 91st Cong., 1st Sess., 77.

[2] P. L. 95-600, Section 421.

[3] S. Rep. No. 95-1263, 95th Cong., 2d Sess., 200-07.

For taxable years beginning after 1982, TEFRA repeals the add-on minimum tax for noncorporate taxpayers. The alternative minimum tax base is expanded by combining the existing tax preferences for both minimum taxes and adding several new preferences. As stated in the Senate Finance Committee Report, the overriding objective is to stop individuals with substantial economic income from avoiding taxes. Although tax incentives have been enacted for worthy goals, they become counterproductive when taxpayers are allowed to use them to avoid virtually all taxes.[4] Furthermore, the changes actually provide tax reductions for many middle-income taxpayers who pay a minimum tax on some preference income but also have substantial amounts of nonpreference income.[5] By adding all tax preferences into the alternative minimum tax base, the tax liability of high-income classes of individuals will be increased.[6]

II. *Overview of the New Alternative Minimum Tax Provisions*

For noncorporate taxpayers, the alternative minimum tax applies when it exceeds the regular tax. The alternative minimum tax is imposed at a flat rate of 20 percent on the alternative minimum taxable income less appropriate exemptions.[7] Section 55(f) allows the exemption amounts of $40,000 for a joint return, $30,000 for a single return, and $20,000 for married persons filing separately, estates and trusts.

The term "regular tax" means the taxes imposed by chapter 1 of the Code (other than the alternative minimum tax and certain additional taxes for annuities under Section 72(m)(5)(B) and (q), lump-sum distributions under Section 402(e), early distributions from individual retirement accounts under Section 408(f), early redemptions of retirement bonds under Section 409(c), and accumulation distributions from certain trusts under Section 667(b)) reduced by all nonrefundable credits, including the foreign tax credit under Section 33(a).[8]

A. Alternative Minimum Taxable Income.—Alternative minimum taxable income means the adjusted gross income (determined without regard to the regular net operating loss deduction under Section 172) increased by the amount of tax preferences and reduced by (1) the "alternative tax net operating loss deduction," (2) the alternative tax itemized deductions, and (3) any accumulation distributions from certain trusts under Section 667.[9]

The "alternative tax net operating loss deduction" is the same as the regular net operating deduction, except that the items of tax preference arising in such year are added back to taxable income, and only minimum tax itemized deductions (as modified under Section 172(d)) are taken into account.[10] In any year to which a minimum tax net operating loss may be carried, the loss is reduced by the alternative minimum taxable income in the carryover year (whether or not the taxpayer is subject to the minimum tax that year).[11] These rules are illustrated in the Senate Finance Committee Report as follows:

> For example, if in year one a taxpayer has $20,000 of income and $35,000 of losses, of which $10,000 are preference items, the minimum tax net operating loss for the year is $5,000. Thus, in any subsequent (or prior) year, a $5,000 net operating loss deduction will be allowed to reduce income subject to the alternative minimum tax. Assume that in year two, the taxpayer has $20,000 of minimum taxable income (without regard to the net operating loss deduction) and $20,000 of preferences. The taxpayer will be allowed to reduce his minimum taxable income to $15,000 by the $5,000 net operating loss deduction. The net operating loss deduction for purposes of the regular tax will not be affected by this computation (i. e., the taxpayer will have a loss carryover of $15,000 from year 1 to be used under the regular tax in subsequent years).[12]

Pre-1983 regular tax net operating losses may be carried forward as minimum tax net operating losses to 1983 and subsequent years until used up. However, pre-1983 preferences that have created a net operating loss carryover will continue to be subject to the repealed add-on minimum tax.[13] That is, any pre-1983 add-on minimum tax becomes payable as the taxpayer receives tax benefits from the net operating loss carryover.

B. Alternative Tax Itemized Deductions.—In computing the alternative minimum taxable income, certain itemized deductions are allowed.[14] These deductions include: (1) medical expenses under Section 213, but only to the extent the expenses exceed 10 percent of adjusted gross income instead of the 5 percent limit in computing the deduction for taxable income, (2) casualty losses under Section 165(c)(3), (3) wagering losses under Section 165(d), (4) charitable contributions under Section 170, (5) estate taxes paid under Section 691(c), and (6) qualified interest defined in Section 55(e)(3). Qualified interest includes any "housing interest," and the amount of any other interest deductions to the extent of "net investment income" included in the minimum tax base for the taxable year. "Housing interest" includes interest on debt incurred in acquiring, constructing, or substantially rehabilitating the taxpayer's principal residence (within the meaning of Section 1034), or a "qualified dwelling" used by the taxpayer or any member of his family during the year.[15] A "qualified dwelling" can be a house, an apartment, a condominium, or a mobile home (not used on a transient basis), and all structures or other property apurtenant thereto are included.[16] Interest on debt incurred before July 1, 1982, which is secured by the principal residence or by a qualified dwelling is housing interest, even though the debt has not been incurred for acquiring, constructing, or rehabilitating the taxpayer's residence or dwelling.[17]

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[4] S. Rep. No. 97-494, (Vol. 1) 97th Cong., 2d Sess., 108.

[5] Ibid.

[6] Ibid.

[7] Sec. 55(a).

[8] Sec. 55(f)(2).

[9] Sec. 55(b).

[10] Sec. 55(d)(2)(A).

[11] S. Rep. No. 97-494, p. 111.

[12] Ibid.

[13] Ibid.

"Net investment income" sets the ceiling for deducting all interest expenses (other than qualified housing interest) in computing the alternative minimum taxable income. "Net investment income" is the excess of qualified investment income over qualified investment expenses.[18] Qualified investment expenses are deductions allowable in computing adjusted gross income. They are directly connected with the production of investment income and are not items of tax preference. Tax preference deductions are excluded and therefore do not reduce the qualified net investment income. Qualified investment income includes: (1) gross interest, dividends, rents and royalties, (2) net capital gain on the sale of investment property, (3) interest and dividends excluded from gross income under Section 116 or 128, and (4) any income derived from a limited business interest. The term "limited business interest" means an interest as a limited partner or as an S corporation shareholder who does not actively participate in the management of such corporation.[19] Interest incurred for purchasing or carrying a limited business interest is not allowable in computing adjusted gross income for alternative minimum tax purposes. However, it is deductible to the extent such interest and other interest do not exceed qualified net investment income.

C. Items of Tax Preference.—The adjusted itemized deduction and the amortization of child care facilities are no longer treated as tax preferences under TEFRA. The items of tax preference[20] under TEFRA are:

(1) Accelerated depreciation on real property in excess of straight-line depreciation over a 15-year period;

(2) Accelerated depreciation on leased personal property in excess of straight-line depreciation based on the applicable recovery period under Section 57(a)(12);

(3) Amortization of certified pollution control facilities (the excess of 60-month amortization over depreciation otherwise allowable);

(4) Percentage depletion in excess of the adjusted basis of the property;

(5) Intangible drilling costs on oil, gas, and geothermal wells in excess of the amount amortizable with respect to the cost, and in excess of net income from production;

(6) The bargain element at the time of exercise of incentive stock options as defined in Section 422A;

(7) Mining exploration and development costs, research and experimental costs, and circulation expenditures in excess of the amounts that would have been allowable for the taxable year if the costs and expenditures had instead been amortized over a 10-year period;

(8) Capital gains deduction; and

(9) Interest excluded under the all-savers and net interest exclusions beginning in 1985 under Section 128 and the dividend income exclusion under Section 116.

Deductions for mining exploration and development costs, for research and experimental costs, for circulation expenditures, and for intangible drilling costs can be excluded as tax preferences if the taxpayer elects to amortize the deduction over a 10-year period.[31]

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[14] Sec. 55(e).
[15] Sec. 55(e)(4)(A).
[16] Sec. 55(e)(4)(B).
[17] Sec. 55(e)(4)(C).
[18] Sec. 55(e)(5).
[19] Sec. 55(e)(8).
[20] Sec. 57(a).

D. Credits.—The nonrefundable tax credits, other than the foreign tax credit, may not be deducted from the alternative minimum tax. Any credits not allowed against the alternative minimum tax can be carried back or carried over as a credit against regular tax under the rules for that particular credit. The amount of carryovers to future years from a year in which the taxpayer is liable for an alternative minimum tax is not to be reduced to the extent of the taxpayer's alternative minimum tax liability. This is illustrated in the Senate Finance Committee Report:

> For example, if a taxpayer has a regular tax liability before credits of $10,000, investment tax credits of $5,000, and alternative minimum tax before regular tax offset of $8,000, the taxpayer will pay a tax of $8,000 (consisting of regular tax of $5,000 and alternative minimum tax of $3,000). In this case the taxpayer has used up all $5,000 of investment tax credits against regular tax but has received a benefit only from $2,000 of credits. Thus, if the credit would not otherwise expire, the remaining $3,000 of credit for which no tax reduction was obtained is to be available as an additional carryover to the next year to which the credit would be carried over under the usual rules.[32]

The foreign tax credit is allowed to the extent of the foreign tax on a taxpayer's foreign-source alternative taxable income under Section 55(c)(2). The computation is rather complicated. Those who are affected might want to consult Seago.[33]

E. Computation of the Alternative Minimum Tax.—The application of the alternative minimum tax is shown in Illustration 1. Assume married taxpayer X has salary income of $150,000, interest and dividend income of $10,000 (net of the $200 dividend exclusion), and net long-term capital gain of $200,000. His itemized deductions amount to $73,000. In addition, he has exercised an incentive stock option for $20,000 when the market value of the stock is $70,000. Thus, the bargain element of $50,000 is a tax preference under TEFRA. He is filing a joint return and claiming four exemptions for 1983.

The computation of X's regular and alternative minimum taxes is shown in Illustration 1. His 1983 regular income tax is $67,202 on a taxable income of $166,400. However, the alternative minimum tax will apply; the 20 percent tax on the alternative taxable income of $348,200 exceeds the regular tax of Chapter 1 by $2,438. X's 1983 total tax liability is $69,640 (consisting of regular tax of $67,202 and alternative minimum tax of $2,438).

III. *Effects of the Alternative Minimum Tax on Tax Planning*

In those circumstances where a taxpayer is subject to the alternative minimum tax, his marginal tax rate is 20 percent. However, the alternative minimum taxable base is broader than the base for regular taxable income. Thus, the taxpayer may have a larger total tax liability even though he is in a relatively low (20 percent) tax bracket. It is critical to know at what point the alternative minimum tax will apply. When the alternative minimum tax is inevitable, proper timing of certain income and deductions will minimize its impact.

A. Timing of Income and Deductions.—Using the basic facts in Illustration 1 and varying the amounts of certain income and deductions, the effects on the regular and alternative minimum taxes are shown in Illustration 2.

In situation 1, increasing X's ordinary income by $5,000 increases his tax liability by $1,000. However, he is still subject to the alternative minimum tax, and his marginal tax rate is 20 percent. If the $5,000 income were deferred to 1984, it would most likely be taxed at a higher rate unless the alternative minimum tax applies.

In situation 2, reporting only 50 percent of the capital gain under the installment method reduces X's tax liability by $20,000. The alternative minimum tax still applies and his marginal tax rate is 20 percent. The deferred gain will also be taxed at 20 percent—the maximum in 1984.

In situation 3, prepaying the state income tax of $10,000 does not reduce X's total tax liability, since the state income tax deduction is not an alternative tax itemized deduction in computing the alternative minimum taxable income.

In situation 4, an additional charitable contribution of $5,000 reduces X's total tax liability by $1,000. He is still subject to the alternative

(Text is continued on page 520.)

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[31] Sec. 57(d).

[32] S. Rep. No. 97-494 at 111.

[33] W. E. Seago, "The New Alternative Minimum Tax," 10 *The Tax Advisor* 324 (1979).

Illustration 1

Computation of Regular and Alternative Minimum Taxes

	Regular Tax	Alternative Minimum Tax
Ordinary income:		
Salary	$150,000	$150,000
Interest and dividends	10,000	10,000
Preference income:		
Long-term capital gain (net of 60% deduction)	80,000	80,000
Adjusted gross income	$240,000	$240,000
Alternative tax itemized Deductions:		
Medical (net of limitations 5% and 10%)	$ (1,000)	$ —0—
Casualty loss (after limitation)	(2,000)	(2,000)
Qualified interest	(15,000)	(15,000)
Charitable contributions	(5,000)	(5,000)
	$(23,000)	$(22,000)
Other itemized deductions:		
State income taxes	$(20,000)	
Others: taxes, interest, nonbusiness deductions	(30,000)	
Zero bracket amount	3,400	
Exemptions	(4,000)	
	$(50,600)	
Taxable Income	$166,400	
Adjustments for minimum tax base:		
Long-term capital gain deduction		$120,000
Incentive stock option		50,000
Dividend exclusion		200
Exemption (Section 55(f))		(40,000)
Alternative minimum taxable income		$348,200
Tentative taxes	$ 67,202	$ 69,640
Excess as alternative minimum tax	2,438	
Total income taxes payable	$ 69,640	$ 69,640

Illustration 2

Computation of Regular and Alternative Minimum Taxes

	Regular Tax	Alternative Minimum Tax
Situation 1		
Taxable amount	$166,400	$348,200
Increase in ordinary income	5,000	5,000
Adjusted taxable amount	$171,400	$353,200
Tentative taxes	$ 69,702	$ 70,640
Excess as alternative minimum tax	938	
Total income taxes payable	$ 70,640	$ 70,640
Situation 2		
Taxable amount	$166,400	$348,200
Report only 50% of the capital gain	(40,000)	(100,000)
Adjusted taxable amount	$126,400	$248,200
Tentative taxes	$ 47,202	$ 49,640
Excess as alternative minimum tax	2,438	
Total income taxes payable	$ 49,640	$ 49,640
Situation 3		
Taxable amount	$166,400	$348,200
Prepay additional state income tax	(10,000)	
Adjusted taxable amount	$156,400	$348,200
Tentative taxes	$ 62,202	$ 69,640
Excess as alternative minimum tax	7,438	
Total income taxes payable	$ 69,640	$ 69,640
Situation 4		
Taxable amount	$166,400	$348,200
Additional charitable contribution	(5,000)	(5,000)
Adjusted taxable amount	$161,400	$343,200
Tentative taxes	$ 64,702	$ 68,640
Excess as alternative minimum tax	3,938	
Total income taxes payable	$ 68,640	$ 68,640

	Regular Tax	Alternative Minimum Tax
Situation 5		
Taxable amount	$166,400	$348,200
Tax shelter loss (50% is tax preference)	(50,000)	(25,000)
Adjusted taxable amount	$116,400	$323,200
Tentative taxes	$ 42,202	$ 64,640
Investment tax credit	(5,000)	
Excess as alternative minimum tax	27,438	
Total income taxes payable	$ 64,640	$ 64,640
Situation 6		
Taxable amount	$166,400	$348,200
Increase in ordinary income	8,127	8,127
Adjusted taxable amount	$174,527	$356,327
Tentative taxes	$ 71,265	$ 71,265
Excess as alternative minimum tax	0	
Total income taxes payable	$ 71,265	$ 71,265
Situation 7		
Taxable amount	$166,400	$348,200
Increase in ordinary income	8,200	8,200
Adjusted taxable amount	$174,600	$356,400
Tentative taxes	$ 71,302	$ 71,280
Excess as alternative minimum tax	0	
Total income taxes payable	$ 71,302	

(Text continued from page 517.)

minimum tax and his marginal tax rate is 20 percent. If the deduction were taken in 1984, it would yield a bigger tax savings since X's regular marginal tax rate will most likely exceed 20 percent unless the alternative minimum tax applies.

In situation 5, X invests in a tax shelter which provides him an ordinary loss of $50,000 and an investment tax credit of $5,000. However, 50 percent of the loss is tax preference. The $50,000 loss reduces his tax liability by $5,000. The tax benefit is only 10 percent, since 50 percent of the loss is tax preference and the alternative minimum tax rate of 20 percent still applies. The investment tax credit of $5,000 cannot offset the alternative minimum tax, but is available for carryback or carryover to another year.

In situation 6, increasing X's ordinary income by $8,127 increases his tax liability by $1,625. The marginal tax rate is 20 percent. At this point, his regular tax equals his alternative minimum tax. However, further increases in ordinary income will subject him the regular marginal tax rate of 50 percent. This is illustrated in situation 7. The optimal amount of $8,127 can be determined mathematically when the alternative minimum tax is known. The optimal amount is the quotient of the alternative minimum tax divided by the rate differential of the regular and alternative minimum taxes. In this case, the alternative minimum tax is $2,438, as shown in Illustration 1, and the rate differential is 30 percent (50 percent regular tax rate minus 20 percent alternative minimum tax rate). The alternative minimum tax of $2,438 divided by 30 percent equals $8,127.

In situation 7, increasing X's ordinary income by $8,200 increases his tax liability by $1,662. He is no longer subject to the alternative minimum tax. The additional $73 income ($8,200 minus $8,127, as used in situation 6) is taxed at his regular marginal tax rate of 50 percent. ($73 × .50 + $1,625 = $1,662.)

As shown in situations 1 through 5, when X is subject to the alternative minimum tax, any additional income he receives is taxed at a rate of, at most, 20 percent; any additional deduction that he takes yields, at most, a 20 percent tax benefit. Certain nonalternative tax itemized deductions, such as state income tax, may yield no tax benefit at all. Any additional capital gain is taxed at the same marginal tax rate of 20 percent as any other ordinary income. While increasing income and reducing deductions will increase his current tax liability, it is only at the alternative minimum tax rate of 20 percent, which is generally lower than his regular marginal tax rates at most income levels. Thus, when the application of the alternative minimum tax cannot be avoided, accelerating the recognition of additional income and postponing deductions to a year in which his regular marginal tax rate is 50 percent can result in a tax savings of 30 percent. Postponing nonalternative tax itemized deductions such as taxes can yield a tax savings up to 50 percent. If the taxpayer's tax year has not closed, there are more opportunities to adjust his income and deductions. For example, a cash-basis taxpayer can attempt to accelerate the collection of his trade receivables. He can also purchase debt instruments that mature and pay interest before his year-end. A stockholder-employee of a closely held corporation may increase his income by paying a dividend and bonus if there is no problem with reasonable compensation. Deductions that can be deferred include property taxes, state income taxes, charitable contributions, medical expenses and interest expenses.

As shown in situations 6 and 7, the combination of postponing deductions and increasing income will eventually place the taxpayer at a point where his regular tax equals his alternative minimum tax. At this point, the alternative minimum tax rate of 20 percent will cease to apply. Any additional income can be taxed at the regular marginal tax rate, which can be 50 percent, and additional deductions can yield tax benefits of up to 50 percent. Thus, the traditional tax planning devices of deferring income and accelerating deductions may become applicable again. This optimal point can be determined by trial and error. In most cases, because of the complexity of the regular tax computation, such as the application of income averaging and limitation of certain deductions, the trial-and-error method may be the only practical approach. However, the following section attempts to derive a formula for determining the optimal amount of deduction, tax shelter, or income that can avoid the alternative minimum tax.

B. Solving for the Optimal Income or Deductions.—Usually, it is possible to express a taxpayer's regular tax and alternative minimum tax liabilities in terms of algebraic formulas. A taxpayer is not subject to the alternative minimum tax when his regular tax equals his alternative minimum tax. Applying this principle and equating the formulas for the two taxes, one can derive a general equation expressed in terms of the relative amounts of income and deduction that would yield the same amount of regular and alternative minimum taxes. These formulas can be expressed as follows:

$$AMT = .2(OI + .4CG - TS - AID + .6CG + .5TS + OP - \$40{,}000)$$

$$RT = .5((OI + .4CG - TS - ID + ZBA - EX) - \$109{,}400) + \$38{,}702$$

AMT = Alternative minimum tax
RT = Regular tax
OI = Ordinary income
CG = Capital gain (at 100 percent)
TS = Tax shelter loss (assuming 50 percent is tax preference)[*]
AID = Alternative tax itemized deductions
ID = Regular tax itemized deductions
ZBA = Zero bracket amount
EX = Exemption(s)
OP = Other tax preferences

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[*] Use some other percentage, if necessary.

Setting AMT = RT, the resulting formula is as follows:

$$.3OI - \$7{,}998 = .2OP + .4TS - .2AID + .5\,ID - .5ZBA + .5EX$$

The above formula is based on the assumptions that the taxpayer is at the 50 percent bracket (taxable income over $109,400) and filing a joint return for 1983. The capital gain is not a determining factor in the above formula, since it is taxed at an effective rate of 20 percent for both taxes when the taxpayer is in the 50 percent bracket. Therefore, different formulas have to be derived for taxpayers at different tax brackets and also for single taxpayers.

The above formula can be used to determine (1) how much the taxpayer can adjust his income or deductions to minimize the impact of the alternative minimum tax when he is subject to it, and (2) how much he can increase his deductions and tax preferences before he is subject to the alternative minimum tax.

Using the basic fact situations in Illustration 1 with the exception that the state income tax deduction of $20,000 is only an estimate, it can be determined by the formula that X's total tax liability will still be $69,640 if only $15,124 in state income tax is prepaid. The amount is computed as follows:

$$.3OI - \$7{,}998 = .2OP + .4TS - .2AID + .5\,ID - .5ZBA + .5EX$$

$$.3\,(\$160{,}000) - \$7{,}998 = .2(\$50{,}200) + .4(\$0) - .2(\$22{,}000) + .5\,ID - .5(\$3{,}400) + .5(\$4{,}000)$$

$$ID = \$68{,}124$$

Total optimal itemized deductions	$68,124
Alternative tax itemized deductions	(23,000)
Other nonalternative tax deductions	(30,000)
State income tax deduction	$15,124

The postponement of $4,876 in state income tax deduction to the following year can yield tax benefits of up to 50 percent. However, each additional dollar reduction in excess of $4,876 will increase his tax liability by $.50.

The next example illustrates how the formula is used to determine the amount of deductions and tax preferences one can increase before he is subject to the alternative minimum tax. For example, X has ordinary income of $300,000 (net of $200 dividend exclusion), alternative tax itemized deductions of $40,000 and other itemized deductions of $60,000. He will file a joint return for 1983 and claim four exemptions. He is considering a tax shelter to defer or minimize his current tax liability. Based on the assumption that 50 percent of the tax shelter loss is tax preference, the amount of tax shelter (TS) X can use is determined to be $99,155 as follows:

$$.3OI - \$7{,}998 = 2OP + .4TS - .2AID + .5\,ID - .5ZBA + .5EX$$

$$.3\,(\$300{,}000) - \$7{,}998 = .2(\$200) + .4TS - .2(\$40{,}000) + .5(\$100{,}000 - .5(\$3{,}400) + .5(\$4{,}000)$$

$$TS = \$99{,}155$$

Illustration 3 demonstrates the effects of the tax shelter loss on the regular and alternative minimum taxes. With the additional tax shelter loss of $99,155, X's regular tax liability is reduced by $49,394 to $34,308, a tax savings of almost 50 percent on each dollar of loss. The alternative minimum tax of $34,125, which is $183 less than the regular tax, will not apply. The computed amount of $99,155 is not the exact optimal deduction and causes the difference of $183 in the two taxes. This is because the marginal tax rate is 48 percent, instead of the 50 percent used in the formula. However, the true optimal point is reached when X increases his tax shelter loss by "L," which can be determined to be $315 as follows:

$$\$34{,}308 - .48(L) = \$34{,}125 + .2(L)$$

$$L = \$315$$

The optimal situation for X is when his taxable income is $99,930 ($100,245 – $315) and his alternative minimum taxable income is $170,780 ($170,623 + 50% of $315). At that point, the chapter 1 regular tax of $34,156 is equal to the alternative minimum tax. Beyond that point, any additional loss or deduction can yield tax savings of zero to 20 percent. For example, if 90 percent of the tax shelter loss is tax preference, $82,629 is the amount of loss that X can take before he is subject to the alternative minimum tax. Once the alternative minimum tax applies, only $.10 of each additional dollar of loss in excess of $82,629 can reduce alternative minimum taxable income, since the other $.90 is tax preference. The tax benefit is only 2 percent (10 percent of the loss times the alternative minimum tax rate of 20 percent). Thus, the effectiveness of a tax shelter as a tax deferral or tax savings device has been greatly curtailed by TEFRA. Furthermore, future ordinary income generated from dispositions of burned-out tax shelters can be taxed at 50 percent. Taxpayers

Illustration 3

Effects of Tax Shelter Loss on Regular and Alternative Minimum Taxes

	Regular Tax		Alternative Minimum Tax
	Without Tax Shelter	With Tax Shelter	
Ordinary income	$300,000	$300,000	$300,000
Tax shelter loss		(99,155)	(99,155)
Adjusted gross income	$300,000	$200,845	$200,845
Alternative tax itemized deductions	$(40,000)	$(40,000)	$(40,000)
Other itemized deductions	(60,000)	(60,000)	
Zero bracket amount	3,400	3,400	
Exemptions	(4,000)	(4,000)	
Taxable income	$199,400	$100,245	
Adjustments to minimum tax base:			
Tax shelter loss (assumed 50% is tax preference)			$ 49,578
Dividend exclusion			200
Exemption			(40,000)
Alternative minimum taxable income			$170,623
Taxes	$ 83,702	$ 34,308	$ 34,125

should evaluate tax shelters primarily on their economic merits rather than just on their tax deferral or savings features.

C. Tax Elections.—Certain tax elections can be used to minimize the impact of alternative minimum tax. As discussed in previous sections, when the taxpayer is subject to the alternative minimum tax, increasing income and reducing deductions can result in a tax savings of up to 50 percent. The following tax elections may be considered in alternative minimum tax planning since they have the effect of increasing income and reducing deductions. However, the binding effects on all subsequent years of some of these elections should be evaluated.

1. Election out of the installment method under Section 453(d);

2. Election of different recovery percentages (determined by using the straight-line method over different recovery periods) under Section 168(b)(3);

3. Election to capitalize taxes and carrying charges under Section 266;

4. Election to include Commodity Credit Corporation loans as income under Section 77;

5. Election to deduct disaster loss in the previous year's return under Section 165(h); and

6. Election to amortize certain research and experimental expenditures over 60 months or longer under Section 174(b)(1).

The following elections added by TEFRA should also be considered in alternative minimum tax planning. For tax years beginning after 1982, Section 48(q)(1) provides that the basis of assets must be reduced by one-half of the investment tax credits unless a reduced credit of 8 percent for 5-year recovery property or 4 percent for 3-year recovery property is elected. In years where the alternative minimum tax applies, any additional investment credits will not yield any current tax benefits. Thus, an election to claim a reduced credit may be desirable. Under Section 58(i)(4), an individual can elect to treat nonlimited partnership intangible drilling and development costs (1) as qualified investment for the credit allowable under Section 38 and (2) as ACRS deductions based on the same applicable percentages as those provided for 5-year recovery property. These costs are subject to the adjustments provided in Section 48(q). Furthermore, deductions for mining exploration and development, research and experimental, circulation expenditures, and intangible drilling and development costs can be excluded as tax preferences if the taxpayer elects under Section 57(d) to amortize the costs over a 10-year period. By foregoing the full current deduction in the year the alternative minimum tax applies, the taxpayer can save most of the deduction for future years when he may be at a higher bracket than 20 percent.

IV. Conclusion

The revamp in the minimum tax system undoubtedly affects a large number of taxpayers, especially those with substantial income and tax preferences. Hopefully, the changes accomplish the intended objectives of combating the abusive use of worthy tax incentives, so that an equitable tax system can be restored and the economic goals of the tax incentives can be met.

Tax advisors should fully understand the implications of the new provisions. Substantial tax savings for clients can be achieved by proper and timely tax planning. This requires careful analysis of the client's income and expenses before the end of his taxable year so that proper courses of action can be taken to avoid or mitigate the implications of the alternative minimum tax. ●

IRS Provides Insurance Company Plan Distribution Reporting Rules

An insurance company that makes lump-sum distributions of insurance and annuity policies under qualified Keogh and corporate retirement plans must, under certain circumstances, meet specific information reporting requirements, according to an IRS letter ruling.

An insurance company requested a ruling as to the application of the information reporting requirements under Code Secs. 6041 and 6047 to lump-sum payments under insurance and annuity policies for qualified corporate and Keogh retirement plans. The company sells life insurance, endowment and annuity contracts to trustees of qualified corporate or Keogh plans and non-trusteed Keogh plans. The company makes lump-sum payments to participants when the policies are surrendered and pays death benefits to beneficiaries under the policies.

According to the IRS ruling, the company is not required to file an information return under Code Sec. 6041(a) for a lump-sum payment made on account of the death of a participant where the payment is made to a trustee of a corporate or Keogh plan for employees other than owner-employees. However, the company is required to file an information return where such a payment is made directly to a participant's estate or to a beneficiary. The IRS also ruled that the company is not required to make an information return under Code Secs. 6041(a) and 6047(a) on the distribution of a life insurance policy by a corporate or Keogh plan trustee to a participant.

The company is required, however, to make an information return under Code Sec. 6041(a) for sums paid on the surrender of a life insurance contract by an individual, other than an owner-employee, who acquired the policy in a distribution from a trusteed corporate or Keogh plan.—Letter Ruling 8320010, CCH INDIVIDUAL RETIREMENT PLANS GUIDE ¶ 5230.

Mr. **Mitchell**. Mr. Harold Franklin.

Mr. Franklin, if you will come up, too.

Are there any other people waiting to testify?

Mr. **Brody**. I am Lex Brody, sir.

Mr. **Mitchell**. Mr. Brody, I do not think we have you on the list, but why don't you come right up here. What I would suggest we do is hear from all three of the witnesses and then put questions after that.

TESTIMONY OF GORO ARAKAWA, DIRECTOR, RETAIL MERCHANTS OF HAWAII

Mr. **Arakawa**. Mr. Chairman, Mr. Hayes, and Mr. Akaka, aloha, I am Goro Arakawa, and I am an officer of Arakawa's, a family-operated country department store in the plantation town of Waipahu.

Mr. **Hayes**. Did you say plantation town?

Mr. **Arakawa**. Yes.

Mr. **Mitchell**. But it is not the same plantation you are talking about.

Mr. **Franklin**. It might be. You never know.

Mr. **Arakawa**. Sugar plantation. We have been in business in the islands for 74 years. We serve the plantation town workers, retirees, and generally the economically disadvantaged of the leeward area of Oahu, which is very well known to Mr. Akaka demographically.

Today I would like to talk about deregulating credit card finance charge rates. In Hawaii—as in many other States—we have a ceiling on the interest rates that can be charged on credit cards. Our legal ceiling is 18 percent, which is unchanged in the past 16 years.

The Arakawa store has been offering our own credit card to customers for a long time, but we found that running a credit operation is very expensive for us. Credit card administration, bad debts, and the cost of borrowing money actually cause us to lose money on our credit operation. The 18-percent ceiling simply does not give us enough leeway to cover our costs. We can find ourselves in an automatic money losing situation over which we have no control and which can become a matter of survival for a small business.

I would suggest that the Congress amend the Depository Institutions Deregulation and Monetary Control Act of 1980 [DIDMCA] to preempt States from setting ceilings on credit card interest rates. This would provide relief to Arakawa's and to many other small retailers throughout the country who offer their own credit cards.

There are two good reasons why the Congress should deregulate credit card interest rates. First, rate ceilings that are set too low will actually reduce the supply of credit to local borrowers.

For example, we at Arakawa's will not accept a marginal credit card risk if our overall credit operation is losing money. We simply cannot take the chance that this marginal risk will end up as a bad debt. So the marginal risk suffers because he cannot get credit from us. If there were no ceiling and we were able to charge a fair interest rate where we would not be losing money, we would be more willing to take a chance on the marginal risk.

The second reason for deregulation is that cash customers end up subsidizing credit card customers when our credit operation is losing money. We charge our customers the same prices on merchandise, whether they pay in cash or by credit card.

I believe that almost all stores in the country have the same policy. Now when our credit operation loses money, we have to raise the prices on our merchandise to maintain our profit margins.

Since both cash and credit card customers must pay the higher prices, that means that the cash customer is actually helping to pay for the credit privileges of our credit card customer. If you were to deregulate interest rates, we would be able to cover our credit card costs and avoid having to charge higher prices to all of our customers.

In closing, let me urge you to seriously consider the deregulation of credit card interest rates. By making this change, you will be benefiting the consumers throughout this country.

Thank you.

[Mr. Arakawa's prepared statement follows:]

PREPARED STATEMENT OF GORO ARAKAWA, DIRECTOR, RETAIL MERCHANTS OF HAWAII

My name is Goro Arakawa and I am an officer of Arakawas, a store in Waipahu, Hawaii. We have been in business in the islands for many years. I am also a director of the Retail Merchants of Hawaii, an affiliate of the Chamber of Commerce of Hawaii.

Today, I would like to talk about deregulating credit card interest rates. In Hawaii—as in many other states—we have a ceiling on the interest rates that can be charged on credit cards. Our legal ceiling is 18%.

The Arakawas store has been offering our own credit card to customers for a long time. But we found that running a credit operation is very expensive for us. Credit card administration, bad debts, and the cost of borrowing money actually cause us to lose money on our credit operation. The 18% ceiling simply does not give us enough leeway to cover our costs.

I would suggest that the Congress amend the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) to preempt states from setting ceilings on credit card interest rates. This would provide relief to Arakawas and to many other small retailers throughout the country who offer their own credit cards.

There are two good reasons why the Congress should deregulate credit card interest rates. First, rate ceilings that are set too low will actually reduce the supply of credit to local borrowers. For example, we at Arakawas will not accept a marginal credit card risk if our overall credit operation is losing money. We simply cannot take the chance that this marginal risk will end up as a bad debt. So the marginal risk suffers because he cannot get credit from us. If there were no ceiling and we were able to charge a fair interest rate where we would not be losing money, we would be more willing to take a chance on the marginal risk.

The second reason for deregulation is that cash customers end up subsidizing credit card customers when our credit operation is losing money. We charge our customers the same prices on merchandise, whether they pay in cash or by credit card. I believe that almost all stores in the country have the same policy. Now when our credit operation loses money, we have to raise the prices on our merchandise to maintain our profit margins. Since both cash and credit card customers must pay the higher prices, that means that the cash customer is actually helping to pay for the credit privileges of our credit card customer. If you were to deregulate interest rates, we would be able to cover our credit card costs and avoid having to charge higher prices to all of our customers.

In closing, let me urge you to seriously consider the deregulation of credit card interest rates. By making this change, you will be benefiting the consumers throughout this country.

Thank you.

Mr. MITCHELL. Thank you, sir.

I have some comments but I want to hear from all the witnesses. Can you stay for a few more moments?

Mr. **Arakawa**. Yes.

Mr. **Mitchell**. Mr. Franklin, do we have a written testimony from you?

Mr. **Franklin**. No, I have just written it.

Mr. **Mitchell**. It would be extremely beneficial if you would prepare it in sufficient copies. How many copies do we need?

Mr. **Powers**. We will get by on what we have with the reporter now, sir.

Mr. **Mitchell**. OK; fine. Go right ahead.

Mr. **Franklin**. Thank you, Mr. Chairman.

TESTIMONY OF HAROLD H. FRANKLIN

Mr. **Franklin**. My name is Harold H. Franklin. I live in Honolulu. Mililani, to be specific.

Mr. **Hayes**. Could you pull the mike over?

Mr. **Franklin**. I had founded a management consultant firm about 8 years ago. Last year I moved to Honolulu to practice my craft.

Before I get to the specifics about SBA and your jurisdiction, I want to share with you some of the clients that I have worked for on the mainland during the last 21 years.

I have worked for Standard Oil of Indiana, about five different assignments with them. I have worked for the Boeing Co. I have worked for McDonnell Douglas Corp., Hughes Aircraft Co., TRW, United States Steel Southworks in Chicago, General Electric, Kaiser Aluminum and Chemical Corp.

The reason I give you this list—and all of these corporations are on the Fortune 500, by the way, and those 8 I named have assets over $25 million. Amoco Corp., Amoco Production Co., is the seventh largest oil company in the world, but it has for the last 20 years the highest percentage of profits than any company. The reason I say that, they are a well-managed company but they are also seeking additional management consultation to improve on their excellence.

I have also worked here in Hawaii with Hawaii Electric Co., which is one of the largest employers on this island. As a matter of fact, it has subsidiaries on Maui and the big island, also.

But my concern about the SBA infrastructure here in Hawaii is similar to the one that I had, a very intimate relationship within Seattle, region 10. It is one that the infrastructure is wedded in the past. It has taken what was a novel and creative idea and turned it into a bureaucratic mess.

Let me just read off some of the events. First, SBA will ask you for collateral or equity. Then they will run you through a commercial bank who doesn't want to see you in the first place. Then you have miles and miles of redtape and if the redtape doesn't kill you, the bureaucracy will. They are overwhelmingly conservative. They are all success-oriented. I want to explain that. I have to guarantee success before I can get a loan. That is what I mean by that.

They are not in the capital risk business. That is what they will tell you. They will say that we have to protect other people's money, which I am aware of, but they do not provide the technical resources that will help people secure a loan, and the length of time it takes to process the loans does cause a lot of heartaches. As you stated earlier, Mr. Chairman, some of the small businesses go out of business waiting on loans to be processed.

That is a tactic of SBA. It is not done by omission; it is done by commission. As you suggested earlier, the small business or the minority business should be competing with Amoco or with the Boeing Co. or with all those other megabuck international companies, which is really ridiculous.

I am just pointing out and highlighting how an innovative idea has become bogged down and has become or gotten in bed with these companies so that—in the past, when they started out 50 to 100 years ago, they got loans from their Government to get started. I am just saying now when the small or minority business comes along, we are looked at as, "This is not your game; this is our game and you cannot really participate."

This is the message. I am sure you may have other testimony that will point that out.

The financial statements they ask you for I am concerned about because there are a lot of confidential revelations on those statements and they make you prove you don't need a loan before they talk to you or you have such enormous resources that before they will even look at you. One of the fortunate aspects of this is I do have a lot of collateral and equity but I don't have much cash.

I am concerned about the fact that once I submit those kinds of statements, what happens to them? Are they acted on with dispatch or are they just sitting there to watch the negative cash flow build up and I am no longer a problem?

I have great concerns because the SBA, one, they talk about all of the things that the larger companies talk about. They are not innovative or creative. They are not looking at risk capital.

A small business person is in the risk business. They don't understand that, though. This is the major problem with SBA both in Seattle region 10 and here in region 9 in Hawaii, because their economics are based on the old economics.

What I am recommending, Mr. Chairman, is that we do the following things. Your committee can do these things.

Have it as a mandate for any SBA in any regions in the United States, in all the States and its territories, to increase the risk capital, and put emphasis on "risk" because this is what it is in the States.

Increase the direct loans available to the small business entrepreneur.

Encourage small business to seek loans.

This morning I didn't hear either the SBA Administrator or the Governor's representative say they had a program to seek out small business. They are not looking for innovation and creativity.

Increase technical assistance to small business. Right now technical assistance is a farce. There is none in existence. But when you get the papers and they tell you all the kinds of assistance that they will provide.

I am an engineer by education but I got out of engineering because you could make more money in management consulting. I am a trained consultant and I have been in the business for 21 years. When they talk about technical assistance, it is a paper tiger. It has nothing to do with helping people manage their business, and most of the SBA in my experience with them, is based on a lack of management expertise.

They should increase the staff. There should be a reeducation of the SBA in what their mandate is.

I am really concerned about, as I say, the financial statements that they require you to make. I am concerned about two things: the confidentiality of those statements and what happens to those, because once those statements are submitted to the SBA, it can be very detrimental to the person who submits it.

I just think that the confidentiality of dealing with the SBA or whatever arm they have should be tightened considerably.

Thank you.

Mr. **Mitchell**. Thank you.

Mr. Brody.

TESTIMONY OF LEX BRODY

Mr. **Brody**. Thank you. Thank you very much, Mr. Chairman.

I am Lex Brody. I did not learn of this meeting until I was driving to work this morning and there was an announcement on KHVA radio. This was at 5:35 this morning.

Accordingly, I do not have any prepared testimony for you. However, my compadre here, Mr. Sloan, has put together a package for each of you which will, I think, pretty well tells you what the small business community in Hawaii is all about.

Let me tell you about me. I happen to be a local product, born on the outer islands, attended public schools, including the University of Hawaii, where I subsequently finished a business major at the University of California, returned to the islands where I joined the pineapple industry, and after 20 years, I was cannery superintendent of Dole Pineapple.

Subsequently I went into business for myself operating a service station. At the tender age of 43 I was pumping gasoline. Very shortly thereafter, we opened our first store, and that was served by one man.

Subsequently I moved into the town of Honolulu where we opened just a few blocks away from us here and now one of the largest tire operations in the State.

About 1975, I was considering expanding my business again. At that time I had maybe 55 or 56 employees. Upon reflection, I decided that, no, the business climate in Hawaii was of such a character that I should not invest any more money in Hawaii.

I felt there were many things wrong here in Hawaii, and that most of them were a consequence of a lack of good management at the State level. At that time, there were a few that agreed with me that we had numerous problems.

One of the problems was excessive cost of unemployment compensation. We talked about workers' comp. We talked about temporary disability insurance. We talked about many, many things.

We decided that we should zero in on one item and that was the restoration here of the work ethic, that is much of our unemployment here was not really unemployment; that this was a situation that was being fostered by our State government.

In the material which you have before you, you will see the history of this unemployment problem. You will also see what we have done in the area of workers' compensation which we began working on 3 years ago. Next year, we hope to get into other items.

However, back to this small business group, called Small Business of Hawaii, I am the president of it and recently appointed to the position of executive director is the person adjacent to me, Sam Sloan. At the present time, we have a membership of 2,500 businesses. We are growing at the rate of 50 new members per month. We anticipate growing here within 6 to 8 months at the rate of 100 per month.

Now, I will explain to you in very simple terms that we know here in Hawaii, to get things done at the State level, we are going to have to be effective at the ballot box. This is the one thing that is understood. We are hopeful that by 1984, we will be able to spread our wings and we hope that by 1986 we will have learned how to fly and that we will be able to deliver the vote to those people who are, in fact, really friendly to the small business people of Hawaii.

Now, since I am very strong on the subject of training on the job, work experience, I am going to ask Mr. Sloan here just to fill in a little bit and give you some more of the background.

I am losing my voice because of a cold and I think that Sam could do this, give you a few very good comments. Sam, would you go ahead?

Mr. MITCHELL. Just before you do, we appreciate hearing testimony from everyone but, as I have heard you up to this point, it appears to me that yours is a politically oriented kind of association on behalf of small business, that you are primarily targeting in on changes at the State level. If that is correct, I am wondering whether or not you are before the right committee.

Mr. BRODY. Let me say this, if I may, Mr. Chairman. Our principal objective has been to improve the awareness level of the people of Hawaii as to what small business means to Hawaii; that it is the principal economic background of this community. So our principal thrust has been educational.

Now, the political is a very important side line.

Mr. MITCHELL. All right. I merely threw that in as a cautionary word, because obviously the Federal Government has, or a committee of Congress has, no jurisdiction, and indeed no authority, to sit in and have a hearing addressing problems that are essentially problems of political subdivisions rather than of the Federal Government.

If you could give your statement very briefly. I am a little concerned about this testimony.

TESTIMONY OF SAM SLOAN, EXECUTIVE DIRECTOR, SMALL BUSINESS IN HAWAII

Mr. SLOAN. I am Sam Sloan, currently executive director of Small Business in Hawaii. Additional background: I have been here for 24 years. I am a graduate of the University of Hawaii. I presently own and operate my own small business; and in addition to that, I am a professor of economics and finance at Hawaii Pacific College. In order to enjoy the atmosphere and environment, everybody has to have at least three jobs just to meet the payroll.

Just as a bit of additional background and to answer your question directly, as Mr. Brody said, actually the political part of our organization is just one-third of the organization. Basically and primarily, it is educational in nature. Secondarily, it is a self help program completely self-financed to help small businesses. Three, we get involved in political education and action of a nonpartisan nature. We are a nonpartisan political corporation.

But the reason we are here—and we appreciate your indulgence and time to address the committee—is that, first of all, we don't come here as to praise or criticize the Small Business Administration. Just to point out a couple facts we have learned along the way; that is, we are in the business of dealing with small businesses on a daily basis really at a gut level. We operate in an area here that is known as Kakako, and it is densely populated with small businesses. You are in part of it now. If you move down a couple blocks, you will see a tremendous amount of activity.

These are people that do not get to come to hearings like this. They do not even get to come to State legislature hearings, because they are busy working, as you alluded to earlier.

One of the points we have tried to make all along is that it is the responsibility of business to provide their own leadership, to accept the responsibility for what it is they are doing, to comply with legislation and, in fact, if there is a problem, to make that problem known to the appropriate authorities, be they Federal or State.

Mr. Keith of the Department of Planning and Economic Development this morning gave you some statistics which we put in our packet there about the size of small businesses. We really are a small business community here. Most of our members have zero to four employees. While everyone makes speeches about how important small business is, our problem is that the bottom line is we don't really get any results from the problems complained about, and that is at the State and Federal level.

Unlike other business organizations and some other interests which you may call special interests, however, we do not seek more money. In fact, I think one of the problems we have here could be described very succinctly: It is a question of money and personnel. I don't think I have heard a lot of people talk about how we need more money, more programs, more personnel. As I say, in dealing with small business people on a daily basis, those that are in business, those that want to start up businesses, those that have been in businesses and having difficulties, we find it is not a question of money as much as it is oftentimes of identifying the problems and doing something about it as in the case of unemployment compensation or workers comp.

Also, trying to prepare people and let them know they are, in fact, going to have to shoulder the responsibility for their businesses themselves. We talk to a lot of people, and we tell them frankly after we are finished trying to counsel them—we get them help and do everything we can—we say, look, you are not prepared to go into business; in fact, you might be able to get an SBA loan or other help of that nature, but it will not solve your problems unless you do a little more of the work yourself.

We do not, as a matter of principle, accept or seek any Federal or State funds for any of the programs we do. We try to set an example by making sure that any of the programs we do—and we have a number of self-help programs for businesses—are financed by the resources we are able to generate ourselves. We think this is an example.

You can't, on the one hand, complain to government, either Federal or State or both, that you are the problem, and, on the other hand, try to get handouts or subsidies or special handouts. What we are trying to do is have a point of view that shows there is consistency and there is small business willing to take that responsibility themselves. As I said, I think too often all the emphasis is on how much money we can get and how many additional programs we can get.

Our experience has been that really there is something else to that, something else we need. We have dealt with the Small Business Administration. We have recommended that people go to them. We have worked with them as best we could. But I think that everyone so far today has kind of missed the point, at least in terms of how some of our small businesses operate; that they need more than just funding, whether it is Federal or State. They need assurance that if they are going to make testimony, for example, or if they are going to go on record as complaining about something that needs attention, that something will be done about it.

You have heard several times that Hawaii is a unique community, and certainly it is in many respects. It is unique both positively, and we have some negative aspects, as well. The problem has been when problems of the Federal or State nature have come up, normally what happens is that there has been a study commissioned with public funds or there was a task force commissioned. We have study upon study. Our State legislative reference bureau has a number of them. Yet, we don't seem to address the problems that have been well-documented, well-testified to. This is the point we are simply trying to make as it pertains to the State as well as Federal level.

I thank you for the opportunity to participate with you.

Mr. MITCHELL. Thank you very much.

Mr. Arakawa, in your testimony, the thrust of your testimony was deregulation of the credit card business. Obviously, that is beyond the scope of this committee. That would fall under the House Banking and Urban Affairs Committee. Fortunately, I serve as a member of that committee and I will bring your testimony and the problem to the attention of Chairman Annunzio, who chairs the subcommittee on bank credit cards.

I was glad to learn what your problems were, but it is really beyond the jurisdiction of this committee to address that problem. I assure you it will be sent to the chairman of the appropriate subcommittee of the Banking Committee.

Mr. ARAKAWA. Thank you.

Mr. MITCHELL. Mr. Franklin, much of what you have had to say to us we have heard over and over again in other hearings around the country over the years. I have served on the Small Business

Committee, and I must admit I am in substantial agreement with a great deal of what you have to say. SBA has become conservative. When the first loan programs were developed, it was to take the risk that the private sector wouldn't take.

Mr. **Franklin**. Right.

Mr. **Mitchell**. Now we see that turned around almost completely. All we can do is battle against it.

I share your concern about financial statements and the confidentiality of them. You dwelled on this on several occasions.

Do you know of any instance where the confidential financial statements of a company have been leaked by SBA or anyone else or shared by SBA with anyone?

Mr. **Franklin**. No, Mr. Chairman. That is the problem. I don't know what happens to them. When you turn in one of those book forms, you don't get it back. They just say, well, you don't get the loan, or you just don't hear from them.

Mr. **Mitchell**. I have to say in all honesty, I have not in my career in Congress heard of a single instance in which the financial statement of a company which was submitted to the SBA has been in any way abused. I think if that had occurred, I would have known about it. It is a problem that we have to keep an eye on.

I have never, however, been made aware of that kind of thing occurring under all the SBA administrators that have been in office since I have been in office.

You are right; it ought to be safeguarded. But I just don't think we have a problem with regard to leaking that information out. I do think it is incumbent upon SBA to get back to the person who is applying for a loan with something like that, and to explain what the weaknesses or shortcomings are in their financial statement. I think that is just a Government responsibility to do that.

Mr. **Franklin**. That was based on my experience in Seattle. One of the things that happened after I left was that they showed a substantial amount of collateral and equity and the person dealing with that had no idea about the enormity or amount of collateral I had.

Mr. **Mitchell**. I think whether it is SBA or any Government agency, it has a duty and responsibility to share with the citizen who seeks help or assistance from that agency, to share with that person why such help or assistance would not be forthcoming. I would hope that that would be a standard operating procedure.

Mr. **Franklin**. I think it needs to be reemphasized. That is why in the recommendations I say look at the thrust and mandate of why SBA was developed.

Mr. **Mitchell**. Thank you.

Congressman Hayes, comments or questions?

Mr. **Hayes**. Maybe just one question.

Have you, yourself, Mr. Franklin, encountered what you feel is discriminatory treatment because of race?

Mr. **Franklin**. In Seattle, yes. I have not gone to the SBA here. That is why I didn't go, because of the treatment in Seattle.

Let me share with you that experience I had in Seattle. It is very short. I have written it down here.

I had the opportunity to acquire a 10-story building. I was a tenant in that building. The owner of the building was a corporation, but the principal owner was going to sell it to me for $600,000. This was in 1976. He was going to finance 80 percent of it.

I heard about the SBA and I went down there, and the only thing the SBA could turn me down on—all they were looking for—I went down myself because I told the guy if—I said, you show up; they will talk you out of it. Then they said you have to live in the building. The building was 99 percent occupied. There was no concern about the tenants paying because they paid, and I satisfied all those requirements.

Then they asked the owner to come down. They took him out to lunch and wined him and dined him for about 2 hours, and he came back to me and he was laughing, but it was not a ha-ha laugh. He said they talked him out of it. They were so negative. They said, "Why would you give this guy that building?" That is what I am talking about, the subtle nuances. If the guy hadn't been the kind of guy he was, he wouldn't have told me. I am talking about these safeguards. It wasn't their responsibility to ask him why he wanted to do this for me. He was a white guy. "Why you want to do that for him? You don't even know that guy."

But I was a tenant in the building for a year, and he would come from time to time and talk. We developed a relationship.

That building today is worth $10 million in Seattle. That was when Seattle was going through one of its many recessions. Now the property values have really skyrocketed. That is why I say the risk was minimal because the guy was going to finance 80 percent of this $600,000.

That is what I was wanting to share with you.

Mr. MITCHELL. Congressman Akaka.

Mr. AKAKA. No questions.

Mr. MITCHELL. I thank these last witnesses and I thank all of you who stayed with us all day long, or most of the day. It has been a very, very informative hearing for me and for the members of the committee. We appreciate your cooperation.

There are one or two areas we need to get cleared up with SBA, as were alluded to. I more than likely will be doing that through correspondence through the committee pursuing the line of inquiry that Congressman Savage raised.

It is not much fun. I enjoyed Hawaii. It has been great since I have been here. But it is exceedingly difficult when you have a field hearing. We in Congress have so little time with our families. We can't be gone when the House is in session because we don't want to miss votes. Therefore, you have to do it when the House is not in session. Just the sheer logistics of setting up a hearing in the field, particularly like Hawaii, is pretty severe.

Thanks to Tom Powers and the staff of Congressman Akaka, we have been able to pull this one off.

I cite all the problems only in the sort of peripheral manner because the value of hearing directly from you far outweighs any of the problems attendant a field hearing.

Thank you very much. You have given us more work to do, but that is what you pay us for: to do the work. Thank you.

The hearing is now adjourned.

[Whereupon, at 1:40 p.m., the committee adjourned, to reconvene subject to the call of the Chair.]

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